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No. 94-394

IN THE SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1994

TRANSPHASE SYSTEMS, INC.,

Petitioner,

v.

SOUTHERN CALIFORNIA EDISON COMPANY
AND SAN DIEGO GAS AND ELECTRIC COMPANY,

Respondents.

Petition for a Writ of Certiorari to the
United States Court of Appeals
for the Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

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September 1, 1994

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I. QUESTIONS PRESENTED

1. Is the "state action" doctrine, as enunciated in Parker v. Brown, 317 U.S. 341 (1943) and its progeny, available to provide immunity to an electric utility or other private corporation that monopolizes a market in violation of Section 2 of the Sherman Act?

2. If "state action" immunity is available, then under the first-prong of the Midcal test, does State legislative authorization to regulate supersede recent and affirmative legislative enactments promoting competition in the relevant market, thereby enabling a state regulatory agency alone to immunize a corporation from federal antitrust law?

3. Under Midcal's second-prong, where the issue is the actuality of price-setting and control by the regulators, should a district court convert defendants' motion to dismiss under Rule 12(b)(6), Fed.R.Civ.P., to a motion for summary judgment as plaintiff moved to allow the parties to establish a record on disputed issues of fact, in accordance with Rule 12(b), Fed.R.Civ.P. and Rule 201(b), Fed.R.Evid?

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Cal. Pub. Util. Code § 747 . . . 4,27, App. 21a-22a

Cal. Pub. Util. Code § 454(a) . . 4,15,27, App. 23a

Cal. Pub. Util. Code § 701.1(c) . . 4,28, App. 24a-25a

OTHER AUTHORITY

Areeda and Hovenkamp, Antitrust Law, 1993 Supplement, Little, Brown and Company 20

Transphase Systems, Inc. ("Transphase") hereby petitions the Supreme Court of the United States for a writ of certiorari to review the judgment in this case of the United States Court of Appeals for the Ninth Circuit.[1]

III. ORDERS BELOW

The Order of the United States Court of Appeals for the Ninth Circuit is found in the appendix at 1a to 2a. The Order of the United States District Court for the Central District of California is included in the appendix at 3a-17a. The Court of Appeal's order denying petitioner's rehearing motion, with petitioner's suggestion for rehearing in banc, is included in the appendix at 18a to 19a.

IV. JURISDICTION

The Court of Appeals rendered its judgment on May 9, 1994. A petition for rehearing was denied on June 9, 1994. This court has jurisdiction under 28 U.S.C. §1254(1).

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[1]Transphase Systems, Inc. has no parent or subsidiary corporations. All parties to the proceeding appear in the caption to the case.

V. CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

A. Constitutional and Federal Statutory Provisions (Question 1)

Constitution of the United States, Article VI:
Clause 2. Supreme Law

This Constitution, and the Laws of the United States which shall be made in Pursuance thereof, and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

The Sherman Act, Title 15 United States Code §1 and 2:

Section 1. Trusts, etc., in restraint of trade illegal; penalty

Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal...

Section 2. Monopolization; penalty

Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding $10,000,000 if a corporation, or, if any other person, $350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

(July 2, 1890, ch. 647, §1, 2, 26 Stat. 209; As amended Nov. 16, 1990, P.L. 101-588, §4(b), 104 Stat. 2880.)

Title 15 U.S.C. Section 15: Suits by persons injured.

...[A]ny person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefore in any district court of the United States in the district in which the defendant resides or if found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee.

B. California Statutory Provisions (Question 2)

Chapter 984, California Statutes of 1983:

The Legislature finds and declares it is in the best interest of the state to ensure competition in the energy conservation industry because of the innovation, price competition, aggressive marketing, and freedom of entry which characterize competitive industries, and that the energy conservation industry, because of its decentralized nature, has the potential to be truly competitive.

The Legislature further finds and declares that the current uncertainty with regard to the role of electrical and gas corporations subject to regulation as public utilities by the Public Utilities Commission with regard to energy conservation development hinders the full-scale development of the energy conservation industry, and therefore requires legislative clarification.

The Legislature further finds and declares that there may be an inherent conflict for a public utility which furnishes gas

and electricity on the one hand and installs energy conservation materials or devices on the other hand, and that it would be detrimental to the energy industry and to the state if privately-owned public utilities used their status as monopolies to dominate the energy conservation industry or exercise unfair market power.

The Legislature further finds and declares that the basis for regulation of public utilities extends to their participation in energy conservation development as well as in the production and delivery of forms of energy derived from conventional sources.

It is, therefore, the intent of the Legislature that the Public Utilities Commission be given a clear and explicit mandate to regulate the involvement of electrical and gas corporations in energy conservation development, and to ensure that the energy conservation industry develops in a manner which is competitive and free from the potential dominance of regulated electrical and gas corporations.

Other California Legislative Enactments In Appendix:

California Public Utilities Code §744.7(e)	App. 20a
Chapter 1369, California Statutes of 1990 (Incorporates California Public Utilities Code §747)	App. 21a-22a App. 21a-22a
California Public Utilities Code §454(a)	App. 23a
California Public Utilities Code §701.1(c)	App. 24a-25a

VI. STATEMENT

A. Limitation of Petition to "State Action" Doctrine

On May 3, 1993, Transphase filed a private antitrust action against Southern California Edison Company ("SCE") and San Diego Gas and Electric Company ("SDG&E") in the United States District Court for the Central District of California. The complaint charged the utilities with monopolizing and attempting to monopolize the distribution of energy efficiency services to ratepayers and thermal energy storage ("TES") equipment installed at host customer facilities, in violation of the Sherman Act, §2 (15 U.S.C. §2), among other antitrust counts. As prayers for relief, Transphase's Complaint sought monetary damages under 15 U.S.C. §15 and injunctive relief. The district court had jurisdiction in this action under 28 U.S.C. §1331 (federal question jurisdiction).

On June 14, 1993, SCE and SDG&E filed motions to dismiss the complaint under Federal Rule 12 (b)(6) for "failure to state a claim upon which relief can be granted". The utilities argued, inter alia, that they were immunized from federal antitrust liability under both the "state action" and Noerr-Pennington doctrines. Transphase opposed the defendants' arguments in reliance on Cantor v. Detroit Edison Co.,428 U.S. 579, 96 S.Ct. 3110, 49 L.Ed.2d 1141 (1976) and express statutory intent promoting competition in the relevant markets. Transphase also moved the District Court to convert the Rule 12(b)(6) motion to a motion for summary judgement on Midcal's second prong and on July 9, 1993, submitted evidence to show lack of active regulatory supervision.

On October 12, 1993, the District Court entered final

judgment granting the defendants' motions to dismiss with prejudice. App. 3a to 17a. The lower court found state-action and Noerr-Pennington immunities for all of SCE and SDG&E's energy efficiency activities. The District Court also dismissed Transphase's complaint on the basis that it did not adequately allege to be a significant competitor of the utilities, although indicating that it would have allowed Transphase to re-plead if the immunity doctrines were not available. App. 16a, n. 10.

Transphase limited its appeal to the U.S. Ninth Circuit Court of Appeals to its Section 2 claims of actual and attempted monopolization as well as a pendent state claim. In a one-sentence decision filed May 9, 1994, the Ninth Circuit affirmed the District Court's dismissal of the case, but limited its basis of affirmance to the District Court's discussion of the "state action" doctrine enunciated in Parker v. Brown, 317 U.S. 341 (1943) and its progeny. App. 1a-2a. On June 9, 1994, the Ninth Circuit denied Transphase's petition for rehearing with a suggestion for rehearing en banc. App. 18a-19a.

Because the Ninth Circuit expressly limited the dismissal to the state-action doctrine, the questions presented in this petition solely concern this doctrine's availability and application to defendant private corporations.

B. The Utilities' Control and Destruction of Energy Efficiency Services and Products

As competitors to Transphase in the provision of electric capacity to the ratepayers, defendants SCE and SDG&E - not the California Public Utilities Commission ("CPUC") - (1) control the price paid to Transphase for the electric capacity and energy savings it provides, and (2) use

this power to destroy the energy efficiency services and equipment markets, to the massive financial detriment of the ratepayers.

Transphase sells electric capacity and energy savings, also known as energy efficiency or demand-side management ("DSM") resources. Transphase provides electric capacity and energy savings through the manufacture, installation and operation of a patented thermal energy storage ("TES") system. The system is typically installed as a retrofit to existing central cooling plants which provide air conditioning and/or process cooling in larger commercial and industrial facilities, such as hospitals, colleges, manufacturing facilities, and office buildings. The system stores cooling capacity during nighttime off-peak electric hours and releases the stored cooling capacity during daytime on-peak hours. In this way, the cooling plant's electricity consumption is shifted from daytime on-peak hours to nighttime off-peak hours. As noted in SCE's own 1993 TES brochure to host customers, "[i]f you shift your energy intensive cooling operation to Edison's off-peak period, the peak demand is reduced, you pay a lower rate, and we can defer constructing new power plants to meet peak demands, keeping rates lower overall."

Across the country, electric utilities receive over $2 billion per year from their ratepayers for the provision of energy efficiency services, also known as load management or energy conservation resources. The defendants in this case alone receive over $150 million per year for the distribution and provision of energy efficiency resources. They collect these funds through the electricity bills paid by all the ratepayers in their service territories. In a manner

analogous to the light-bulb exchange program in Cantor, supra, 428 U.S. at 582, 96 S.Ct. at 3114, the ratepayers "are billed for the electricity they consume, but pay no separate charge..." for the energy efficiency resources. The utilities in turn use the $150 million per year to purchase energy efficiency resources from either the DSM providers such as Transphase, or the host facility owner where the DSM measure is installed, as well as on exorbitant internal administrative costs and paper studies.

The prices that the utilities pay for the energy efficiency services are constituted on the basis of rebates and avoided costs. The utilities have the full authority from state regulators to set these prices at any level they choose within broad limits under the CPUC's "Total Resource Cost" test. The rebate price (on a dollars per kilowatt basis) determines the ratepayers' remuneration to Transphase for the electric capacity it provides and the economic payback period to the host customer considering the installation of a DSM measure. Over the course of the last few years, SCE has varied the price for electric capacity from TES systems from $0 to $600 per kilowatt ("kw") (now set at $0 per kw), while SDG&E has varied its price from $0 to $300 per kw (also now set at $0 per kw). In comparison, SCE and SDG&E have received up to $1500 per kw for distributing Transphase's DSM-based electric capacity to the ratepayers and up to $6000 per kw for distributing electric capacity from new power plants to the ratepayers.

As the term implies, "avoided costs" are the marginal costs displaced by not building power plants and generating electricity. Such avoided costs represent the total maximum price that may be paid for energy efficiency resources under

the CPUC's Total Resource Cost test. The utilities in fact set DSM avoided costs at far lower rates than those set for supply-side costs, but even if they did set DSM avoided costs equal to supply-side costs, the utilities would still have total power to manipulate energy efficiency rebate prices to control the DSM market.[2]

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[2]As an example, SCE lists its avoided cost or "benchmark price" for repowering its San Bernardino power plant at $1350 per kw. When one includes transmission and distribution costs, assume this equivalent avoided cost for comparison with DSM resources is $1500 per kw. Under the CPUC's Total Resource Cost ("TRC") cost effectiveness test, any DSM resource under $1500 per kw is cost-effective, in that its cost is less than the cost of the equivalent supply-side resource.

Under this example, the rebate price could be $1000 per kw and the host contribution $0 per kw, or the rebate price could be $200 per kw and the host contribution $800 per kw. In either case, from the CPUC's perspective, the total cost of the DSM resource would be the same ($1,000 per kw) and the cost-effectiveness of the DSM resource, under the CPUC's TRC test, would be exactly the same.

But obviously, the significance of these two rebate price scenarios is that, under the first scenario ($1,000 per kw rebate and $0 per kw host contribution), the payback period to the host is immediate because the host has no investment and only electric bill savings. The potential market under this scenario is enormous, in that no cognizant host would refuse such an offer from a legitimate seller is proven applicable technology. Under the second scenario, ($200 per kw rebate and $800 per kw host customer payment), the payback on the host-customer's $800 per kw investment might be 7 years, i.e. electric bill savings of $114 per kw per year. At this payback, the market potential might be essentially zero - in other words, few or no hosts would purchase the DSM system at a 7 year payback.

This example assumes only capacity impacts, with no energy

By controlling the price per kilowatt that Transphase receives to between 0 and 20% of what the utility receives, SCE and SDG&E have choked off the supply of energy efficiency resources to the ratepayers. In the process, the utilities are seriously damaging the ratepayers, as well as putting Transphase and dozens of other companies out of business, by distorting the marketplace to far-higher priced new power plants and more expensive (and increasingly unavailable) energy efficiency resources distributed directly by themselves.

VII. REASONS FOR GRANTING THIS PETITION

A. Summary of Reasons: Inter-Circuit Conflict and The Ninth Circuit's Conflict with the Supreme Court

In affirming the dismissal of Transphase's Original Complaint without leave to amend under Federal Rule 12(b)(6), the Ninth Circuit held that no claim or set of facts had been or could be pleaded that would constitute a violation of Section 2 of the Sherman Act because "defendants SCE and SDG&E in Transphase's complaint are immunized from federal antitrust liability by the 'state action' doctrine."[3] App. 1a-2a, District Court Order, App.

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impacts. In reality, the Transphase System generates substantial energy savings as well because power plants operating during nighttime base-load conditions are far more energy efficient than daytime "peaking" power plants.

[3]Conley v. Gibson, 355 U.S. 41, 45-46, 78 S.Ct. 99, 102 (1957): "[A] complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove

11a. This conclusion - that the judiciary can grant sweeping immunity to corporations from federal antitrust law under the "runaway" federal common law known as the "state action" doctrine - directly and unambiguously conflicts with decisions of other United States Courts of Appeals and of this Supreme Court.[4]

Question 1 Summary: In Town of Concord, Mass. v. Boston Edison Co., 915 F.2d 17, 21 (1st Cir. 1990), cert. denied, 499 U.S. 931 (1991), the First Circuit (BREYER, J.) held, in a case involving comprehensively regulated electric rates, that "state action" immunity was unavailable:

> The basic legal principles that govern this monopolization case are well settled. Even though Boston Edison is a regulated firm, it has no blanket immunity from the antitrust laws. See Otter Tail Power Co. v. United States, 410 U.S. 366, 372-75, 93 S.Ct. 1022, 1027-28, 35 L.Ed.2d 359 (1973); see also Cantor v. Detroit Edison, 428 U.S. 579, 596 n. 35, 96 S.Ct. 3110, 3120 n. 35, 49 L.Ed.2d 1141 (1976)...To prove a violation of this statute (Sherman Act §2), a plaintiff must demonstrate (1) that the defendant possesses monopoly power in the relevant market, and (2) that the defendant has acquired or maintained that power by

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no set of facts in support of his claim which would entitle him to relief."

[4]The term "runaway" was used in O'Melveny & Myers v. F.D.I.C. _ U.S. _, 114 S.Ct. 2048, 2055 (1994) (SCALIA, J.) to demonstrate "the runaway tendencies of 'federal common law' untethered to a genuinely identifiable (as opposed to judicially constructed) federal policy."

improper means. (internal quotation marks and citations omitted).

Thus, the First Circuit found no state-action or other regulatory exemption from federal law to be available and that the correct inquiry was whether in fact the defendant utility corporation had violated Section 2 of the Sherman Act.

In similarly rejecting the availability of the state-action doctrine to a state-regulated electric utility corporation, the Seventh and Eighth Circuits quoted from exactly the same passage in Cantor, supra, (STEVENS, J.) that the First Circuit had cited:

> **[T]here can be no doubt about the proposition that the federal antitrust laws are applicable to electric utilities. Cantor, supra, 428 U.S. at 596, n. 35, 96 S.Ct. at 3120.**

City of Mishawaka, Indiana v. Indiana & Michigan Electric Co., 560 F.2d 1314, 1321 (7th Cir. 1977) cert. denied, 436 U.S. 922 (1978) (Mishawaka I); City of Kirkwood v. Union Electric Co., 671 F.2d 1173, 1177 (8th Cir. 1982), cert. denied, 495 U.S. 1170 (1983). See also City of Mishawaka, Indiana v. American Electric Power Company, Inc., 616 F.2d 976, 985 (7th Cir. 1980), cert. denied, 449 U.S. 1096 (1981) (Mishawaka II): ("Parker v. Brown is inapposite" to defendant electric utility corporation.)

In diametrical contrast, the Ninth Circuit in the case at bar and the Third Circuit almost simultaneously in Yeager's Fuel, et. al. v. Pennsylvania Power & Light, 22 F.3d 1260 (3rd Cir. 1994), found that the judicially-created Parker state-action immunity defense can and should be expansively

applied to find that the federal antitrust laws do not apply to investor-owned electric utility corporations, discarding any inquiry into whether the utility had actually violated Section 2 of the Sherman Act.

In so doing, both the Ninth and Third Circuits grossly misconstrued and misapplied the Supreme Court's decision in City of Columbia v. Omni Outdoor Advertising, Inc., 449 U.S. 365, 111 S.Ct. 1344 (1991) (SCALIA, J.) Both circuit courts relied on Omni's state-action standard applied to municipalities to grant immunity to a private utility corporation. App.7a. 22 F.3d at 1267, n. 8. To the exact contrary, Omni, supra, held that Parker immunity is only available to the subordinate state entity, and simultaneously rejected the availability of this doctrine to regulated corporations. Id, 449 U.S. at 379, 111 S.Ct. at 1353.

The defendant investor-owned utility corporations - not the CPUC - monopolize the energy efficiency equipment and services markets, a marketplace where no natural monopoly exists (unlike perhaps the transmission and distribution of electricity) which might thereby preclude exclusionary conduct required to sustain a Section 2 monopolization claim. See Cantor supra, 428 U.S. at 595, 96 S.Ct. at 3120. See Town of Concord, supra., 915 F.2d at 26. Because Congress never intended there to be an implied exemption or repeal for electric utilities from Section 2 of the Sherman Act, see Otter Tail, Cantor, supra, a state or its regulators cannot immunize these corporations from federal law without conflict with the Supremacy Clause of the U.S. Constitution.

As an analysis of first impression, this Court has never clearly delineated between the impropriety of applying the

state-action doctrine to a Section 2 monopolization case against a private corporation, wherein its application amounts to a recision of federal law by judicial fiat, and the appropriate availability of the state-action doctrine to Section 1 conspiracies in restraint of trade, wherein the state's action in setting rates might literally obviate the private price-fixing conspiracy. The case at bar, Cantor, Otter Tail, and the other five Circuit Court cases referenced supra, are all Section 2 monopolization cases against investor-owned electric utilities. Parker, California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97, 100 S.Ct. 937, 63 L.Ed. 233 (1980), Southern Motor Carriers Rate Conf. v. U.S., 471 U.S. 98, 105 S.Ct. 1721, 85 L.Ed. 36 (1985) and F.T.C. v. Ticor Title Ins. Co., _ U.S. _, 112 S.Ct. 2169 (1992), relied on by the Ninth and Third Circuit courts, were all Section 1 price-fixing cases. As a result, the Circuit Courts have criss-crossed Supreme Court precedent and remain in a state of conflict concerning the availability of state-action immunity to a §2 monopolization claim against a private corporation.

In FTC v. Ticor, 112 S.Ct. at 2181, this Court's most recent §1 price-fixing case that applied the doctrine but denied the immunity, Justice Scalia went further in his concurring opinion: "I am skeptical about the Parker v. Brown exemption for state-programmed private collusion in the first place."

Question 2 Summary: In creating an exemption for electric utilities from federal law, the Ninth and Third Circuit courts held that a basic authorization to regulate is all that is required from the State Legislature under the first prong of the two-pronged test enunciated in Midcal, supra.

The courts of the Ninth and Third Circuits turned to the state PUC to establish state policy to displace competition and preempt federal antitrust law, again directly at odds to Supreme Court precedent, including So. Motor Carriers, supra, 471 U.S. at 62, 63, 105 S.Ct. at 1729, 1730.

Unlike the Pennsylvania Legislature in Yeager's Fuel, supra, however, in this case the California Legislature provided a repeated and clarion call for competition - not utility monopolization - in the relevant energy efficiency marketplace. California commanded that "...the energy conservation industry develops in a manner which is competitive and free from the potential dominance of electrical and gas corporations" (Chapter 984, 1983, supra. at p. 3, 4); that energy efficiency resources be allowed "an opportunity to compete on a fair and reasonable basis with generating resources to fulfill future utility resource needs" (Chapter 1369, §1(b), 1990, App. 21a); and, while rejecting SCE's lobbying for antitrust immunity, reaffirmed Chapter 984 "to promote a competitive marketplace for energy efficiency equipment and services." (Cal. Pub. Util. Code, §744.7(e), 1993, App. 20a).

Incredibly, the Ninth Circuit's affirmance relied upon Cal. Pub. Util. Code §454(a) (App. 23a), a statute dating back to 1915 which authorizes the CPUC to regulate electric rates, as establishing the Legislature's clearly articulated, affirmatively expressed intent to displace competition required under the first-prong of the Midcal test. App. 10a. By relying on basic authority to regulate rather than on the Legislature's repeated, express intent to promote competition in energy efficiency, the Ninth Circuit effectively read Midcal's first-prong out of existence for any state-regulated

corporation because by definition the State will have authorized an agency to regulate the corporation.

Question 3 Summary: Under the second prong of the Midcal test, where the factual issue of control turns on whether the CPUC actually established the energy efficiency rebate prices offered by the defendants in the marketplace, the district court took judicial notice of more than 300 pages of CPUC documents submitted with SCE's Motion to Dismiss under Federal Rule 12(b)(6). In direct conflict with the District Court in Yeager's Fuel, however, in this case the District Court denied Transphase's Motion to convert the 12(b)(6) Motion to a Rule 56 Motion for Summary Judgment, as mandated in Rule 12(b), Fed.R.Civ.Proc., so that Transphase could have the District Court consider its submission of publicly available documents showing lack of supervision or control by the regulators over the utilities' actual price-setting of energy efficiency services in the marketplace. App. 8a-9a, n. 5. The Ninth Circuit's affirmance also violated Rule 201(b), Fed.R. of Evid., by wrongfully taking judicial notice of alleged CPUC control - defendants' purported fact that Transphase vigorously disputes and could prove erroneous if the Court considered its submitted material.

The legal and economic implications of this case are enormous. The federal judiciary cannot create an exemption from federal law for a certain class of corporations. The Supremacy Clause of the U.S. Constitution, Supreme Court case law, the state statutes and factual evidence cannot be ignored, as the Ninth Circuit did. Utility ratepayers, like any other consumers, should be afforded the economic advantages of competition in markets where no natural

monopoly exists. To resolve the "state action" doctrine and bring uniformity to widely disparate Circuit Court interpretations, the Supreme Court should grant this petition for Certiorari.

B. Question 1: The First and Seventh Circuits And this Court Have Found the State Action Doctrine Not Available to Immunize A Private Corporation's Monopolization In Violation of Federal Law.

The Ninth Circuit affirmed the dismissal of Transphase's complaint against two investor-owned corporations based on the state-action doctrine first enunciated in Parker v. Brown, supra, in the process straying dramatically from the doctrine announced in Parker v. Brown itself. This Court held that the Sherman Act was not intended to "restrain a state or its officers or agents from activities directed by its legislature." Parker, 317 U.S. at 350, 351, 63 S.Ct. at 313. In contrast, this Court found that based on its legislative history, "[t]he [Sherman] Act is applicable to "persons" including corporations...That its purpose was to suppress combinations to restrain competition and attempts to monopolize by individuals and corporations, abundantly appears from its legislative history." Id.

In misapplying the state-action doctrine to private corporations, both the Ninth Circuit in the case at bar, and the Third-Circuit in Yeager's Fuel, supra, relied upon Parker's progeny, specifically Omni Outdoor Advertising and the principles of federalism and state sovereignty expressed therein. App. 7a, 22 F.3d at 1267, n. 8. In so doing, these Courts of Appeals were blind to the sharp

distinction drawn in both Omni Outdoor Advertising, supra, and Parker v. Brown between the doctrine appropriately applied to subordinate state entities (e.g. a municipality) and its total inapplicability to a regulated corporation. In Omni, 449 U.S. at 379, 111 S.Ct. at 1353, this Court held:

> This does not mean, of course, that the States may exempt private action from the scope of the Sherman Act; we in no way qualify the well established principle that "a state does not give immunity to those who violate the Sherman Act by authorizing them to violate it, or by declaring that their action is lawful." Parker, 317 U.S., at 351, 68 S.Ct., at 314 (citing Northern Securities Co. v. United States, 193 U.S. 197, 332, 344-347, 24 S.Ct. 436, 459-461, 48 L.Ed. 679 (1904)). See also Schwegmann Brothers v.Calvert Distillers Corp., 341 U.S. 384, 71 S.Ct. 745, 95 L.Ed. 1035 (1951)[5]

This statement was not dicta. The Supreme Court refused to apply the state-action immunity doctrine to the defendant regulated bill-board corporation while simultaneously finding immunity for the co-defendant municipality.

The only way to avoid obvious conflict between the state-action doctrine applied to private conduct and the Supremacy Clause - in that this doctrine provides the State

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[5]Emphasis in original. Compare this citation, written for the Court by Justice Scalia, to his concurring opinion in FTC v. Ticor, "[O]ur active supervision doctrine...has not been challenged here, and...I am skeptical about the Parker v. Brown exemption for state-programmed private collusion in the first place." 112 S.Ct. at 2181.

Legislature and PUC with preemptive, immunizing power over §2 of the Sherman Act - would be if Congress had included an implied exemption to the law. However, the Courts have forcefully answered that Congress has never implied an exemption for regulated corporations from the Sherman Act, even with subsequent federal regulatory statutes. See Otter Tail and Cantor, supra as cited in Town of Concord, City of Mishawaka I, City of Mishawaka II, City of Kirkwood, supra.

In stark contrast, the Ninth Circuit in this case judicially-extended a federal common law doctrine to exempt private corporations from federal statute - an immunity so broad that the Ninth Circuit could dispose of the case in one sentence for an inability to state a cause of action. App. 1a-2a. However, the federal judiciary has no authority of any sort to exempt private corporations from federal law intended to apply to such corporations, regardless of state intent.

"In answering the central question of displacement of California law, we of course would not contradict an explicit federal statutory provision." O'Melveny & Myers, supra, 114 S.Ct. at 2054. No federal policy or legislative history exists intending to exempt corporations from the Sherman Act, as is clear from Parker, Otter Tail and Cantor, supra. The Ninth Circuit's declaration of the electric utilities' immunity from federal law is, as described in another context by this Court, "positively probative of the dangers of (this) facile approach to federal-common-law-making" and "demonstrates the runaway tendencies of 'federal common law' untethered to a genuinely identifiable (as opposed to judicially constructed) federal policy." O'Melveny & Myers, 114 S.Ct. at 2055.

Facially, the application of Parker immunity to private parties can be ascribed to the Supreme Court, in particular to its application of the Midcal test in FTC v. Ticor and So. Motor Carriers, supra. However, the seminal state-action Supreme Court cases of Parker, Midcal, So. Motor Carriers and FTC v. Ticor all involved Sherman Act §1 price fixing schemes involving raisins, liquor, trucking and title insurance rates, respectively. The "state action" doctrine applied to §1 price-fixing and the Sherman Act are not inconsistent standards. If the State, through its laws and regulations establishes rates or prices, individual private parties are not colluding to fix prices by simply following those state dictates. As discussed in Areeda and Hovenkamp, Antitrust Law, 1993 Supplement, ¶209.2, "Preemption and Parker State Action Exemption: Same Issue?" p. 107, "[i]n Midcal, for example, the California statute requiring suppliers to state a resale price and dealers to charge that price was preempted, but neither suppliers nor dealers had agreed about resale prices and therefore neither had violated the Sherman Act."

Section 2 actual or attempted monopolization is fundamentally different from §1 price-fixing offenses.[6] A private corporation cannot monopolize a market without violating the offense specified in §2 of the Sherman Act, regardless of whether the private party's conduct is sanctioned by the State or not. The application of the state-action doctrine to a §2 monopolization claim against a private party inherently sets the State's action as preemptive of federal law, which must conflict with the Supremacy

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[6]Section 2's "conspiracy to monopolize" element is excluded for the purposes of this analysis.

Clause.

In applying the judicially-created state-action doctrine to monopolization claims against corporations, the Ninth and Third Circuits have afforded state regulators far greater preemptive authority over the Sherman Act than the judiciary affords federal regulatory programs. Indeed, there is no analogous immunity doctrine to private parties' claims that federal regulatory programs supersede federal antitrust law. "There is nothing in the legislative history (of the Federal Power Act) which reveals a purpose to insulate electric power companies from the operation of the antitrust laws...." Otter Tail, supra, 410 U.S. at 373-374, 93 S.Ct. at 1028.

In Cantor, supra, 428 U.S. at 596, 597, 96 S.Ct. at 3120, 3121, this Court clearly recognized that state regulators held no special preemptive power:

> Congress could hardly have intended state regulatory agencies to have broader power than federal agencies to exempt private conduct from the antitrust laws...[T]he standards for ascertaining the existence of and scope of such an exemption must be at least as severe as those applied to federal regulatory legislation.

In Cantor's holding that the Parker immunity doctrine was not available to a state-regulated electric utility, the Supreme Court emphasized that since a natural monopoly did not exist in the challenged market, the federal antitrust laws apply with full force:

> There is no logical inconsistency between requiring such a firm to meet regulatory criteria insofar as it is exercising its natural monopoly powers and also to comply with antitrust standards to the extent it engages in business activity in competitive areas of the

> economy. Thus, Michigan's regulation of respondent's distribution of electricity poses no necessary conflict with a federal requirement that respondent's activities in competitive markets satisfy antitrust standards. Id., 428 U.S. at 596, 96 S.Ct. at 3120.

There can be no doubt that a natural monopoly does not exist in the energy efficiency marketplace. As the California Legislature recognized in Chapter 984, Statutes of 1983, supra at 3, 4:

> The Legislature finds and declares it is in the best interest of the state to ensure competition in the energy conservation industry because of the innovation, price competition, aggressive marketing and freedom of entry which characterize competitive industries, and that the energy conservation industry, because of its decentralized nature, has the potential to be truly competitive." (emphasis added).

Extending this principle from Cantor, the First Circuit held that where a natural monopoly did exist (in the distribution of electricity) no exclusionary conduct could be found. "Local electricity distribution, after all, is itself considered a "natural monopoly" with service typically provided by a single franchised company to relatively immobile customers." Town of Concord, supra, 915 F.2d at 26.

While Cantor was heavily relied on by Transphase, the Ninth Circuit and District Court Orders would not mention it, and in the Third Circuit its viability was openly questioned. 22 F.3d at 1260. But the Supreme Court in FTC v. Ticor, 112 S.Ct. at 2178, reaffirmed it: "Michigan may regulate its electric utilities without authorizing monopolization in the market for electric light bulbs." And

the First and Seventh Circuits, supra, cited Cantor as the reason not to consider a state-action immunity analysis.

Rather than, as here, immunize an electric utility from a charge of monopolization, courts have typically applied the rigorous elements of a monopolization claim to the utility corporation's conduct: (1) monopoly power in a relevant market, that is, the power to control price or exclude competition: and (2) exclusionary conduct with no legitimate business justification, specifically whether or not the utilities' actions benefitted or were at the expense of the consumers (ratepayers). See, for example, Town of Concord, 915 F.2d at 21. In that "price-squeeze"case, the defendant investor-owned electric utility had a legitimate business justification for not lowering the wholesale rates to the plaintiff municipal utility monopoly - such action would increase retail electric rates, thus damaging the ratepayers. "Indeed, the rule would encourage Edison to seek a retail rate increase so high that a jury could not find the wholesale/retail gap too narrow." Id. at 27.

In the case at bar, the utilities have no legitimate business justification for their predatory and exclusionary conduct. It is SCE and SDG&E - not the state PUC - that controls energy efficiency prices so that competitors such as Transphase receive financial consideration at between 0% and 20% of the prices paid for generation resources, and at substantially lower prices than the utility receives from ratepayers for its own energy efficiency programs. Allowing energy efficiency resource prices to adjust to market prices would increase the supply and demand for such measures in the marketplace, which would in turn reduce the need for new and far more expensive power plants. By choking off

the supply of energy efficiency equipment and the electric capacity and energy savings this equipment provides, the utilities are distorting the marketplace to far higher priced power plants and to their own excessively expensive (and increasingly unavailable) energy efficiency programs, thus damaging their ratepayers. The omnipotent utilities have completely impaired the opportunity of Transphase to compete on the merits, thus willfully acquiring and maintaining their monopoly power.

Transphase can state a claim that the defendants in this case have violated Section 2 of the Sherman Act. The federal judiciary, the state legislature, and/or the state PUC should not be permitted to exempt the defendants from that federal law.

C. Question 2: The Ninth Circuit's Reliance on Legislative Authorization to Regulate Conflicts With this Court's Requirement that the State Legislature Intend to Suppress Competition.

Even if the judicially-created state action doctrine could potentially exempt the defendants from federal antitrust law, the utilities in the case at bar fail both prongs of the Midcal test for state-action immunity. Midcal, 445 U.S. at 106, 100 S.Ct. at 943. While addressing a §1 price-fixing conspiracy claim subject to state-action, the Supreme Court recently held: "For States which do choose to displace the free market with regulation, our insistence on real compliance with both prongs of the Midcal test will serve to make clear that the State is responsible for the price fixing it has sanctioned and undertaken to control." FTC v. Ticor, 112 S.Ct. at 2178. On the first-prong, the Ninth Circuit and District Courts refused to mention the repeated and recent

California legislation that strongly promotes competition in the relevant energy efficiency services and equipment marketplace. Instead the Ninth Circuit affirmed a dismissal which relied on general PUC authority to regulate utilities' rates - found in a statute dating back to 1915 - and a similar PUC authority to regulate the utilities' energy efficiency programs. App. 9a-10a.

Midcal's first prong focus is squarely on the Legislature's competitive intent, not simply whether there is an authority to regulate. "Besides authority to regulate,... the Parker defense also requires authority to suppress competition - more specifically, clear articulation of a state policy to authorize anticompetitive conduct..." Omni, 449 U.S. at 372, 111 S.Ct. at 1350. (internal quotation marks and citations omitted.) Indeed, the issue cannot be whether the regulatory agency is acting in accordance with statutory authority, for that is a question of state law that has nothing to do with whether private corporations are violating federal antitrust law. Id. at 372, 111 S.Ct. at 1349, 1350. The Ninth Circuit's equation of authority to regulate with intent to suppress competition would eviscerate Midcal's first prong because by definition the State Legislature has authorized its agency to regulate the private parties. By nullifying Midcal's first prong, the Ninth Circuit effectively left it to the state PUC to establish competitive intent and have its regulatory decisions preempt federal law.[7]

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[7]Because Town of Concord, Mishawaka I, and Mishawaka II, supra declined to find the Parker doctrine an applicable defense to the challenged state-regulated retail electric rates, these cases did not comment on the respective State's legislative intent. Superfluously, the Eighth Circuit in City of Kirkwood, supra,

Southern Motor Carriers also addressed this principle that the anticompetitive intent must come from the State Legislature, not the State PUC at 471 U.S. at 62, 63, 105 S.Ct. at 1729, 1730:

> The Public Service Commissions...permit collective ratemaking. Acting alone, however, these agencies could not immunize private anticompetitive conduct...*Parker* immunity is available only when the challenged activity is undertaken pursuant to a clearly articulated policy of the State itself, such as a policy approved by a state legislature...or a State Supreme Court. (citations omitted).

Thus, the lower courts' reliance on broad authorization from the state legislature, and specific reliance in Yeager's Fuel on an unpublished report of a bureau of the PUC, 22 F.3d at 1268, 1269, directly conflict with Omni Outdoor Advertising and So. Motor Carriers. The courts below should not allow subordinate state agencies to wield a "FEDERAL LAW PREEMPTED" seal.

Unlike the permissive Pennsylvania statutory framework found in Yeager's Fuel, however, in this case the California Legislature explicitly and repeatedly promotes competition in this sector of the economy, including an express denial of state-action immunity to SCE in energy efficiency equipment and services less than one year ago. In Public Utilities Code 744.7(e), 1993, the Legislature reaffirmed its prior policies "to promote a competitive marketplace for energy efficiency

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found that not only did Cantor preclude the availability of the state-action doctrine, but that the electric utility satisfied neither prong of the Midcal test. 671 F.2d at 1180, n. 15.

equipment and services." App. 20a. In this 1993 Code, the Legislature explicitly reaffirmed Chapter 984, Statutes 1983, supra, p. 3-4, in which the Legislature commanded that "...the energy conservation industry develops in a manner which is competitive and free from the potential dominance of regulated electrical and gas corporations." (emphasis added) In Chapter 1369(§1b), 1990, the Legislature declared that energy efficiency resources be allowed "an opportunity to compete on a fair and reasonable basis with generating resources to fulfill future resource needs" and in Section 3 thereof (PU Code 747) went on to demand that specific bidding systems be tested quickly. App. 21a-22a. Time and again California has demanded competition with administrative oversight to be provided by state regulators.

Instead of discussing these enactments, the Ninth Circuit affirmed the District Court's Midcal first prong discussion, which quotes PU Code §454(a), a statute dating back to 1915 that has nothing to do with energy efficiency rebate prices but authorizes the CPUC to regulate electric rates. App. 23a. Such broad regulation surely does not show Legislative intent to suppress competition in energy efficiency, but that is precisely what the Ninth Circuit affirmed. Also, without noting that PU Code 747 is section 3 of the above-quoted, strongly pro-competitive Chapter 1369, it erroneously relied on this code section as having an anticompetitive intent when the competitive bidding program it creates is an attempt to spur, rather than displace competition. App. 21a, 22a. Indeed, the lower court's reliance on PU Code 747's establishment of DSM bidding pilots to demonstrate intent to limit competition was starkly contradicted by the California Legislature's PU Code 744.7(e) allowing "a competitive bidding process for all or any part of the work to be

performed under these (energy efficiency) programs." App. 20a. The district court also mentioned PU Code 701.1(c), 1990 (App. 24a-25a), which again promotes - not displaces - comparison and competition between energy efficiency and generation resources by including environmental costs in any cost-effectiveness calculation.

If authority to regulate equates with intent to suppress competition where the Legislature expressly seeks to promote competition, the first prong of the Midcal test will have been interpreted out of existence.

D. Question 3: The District Court's Refusal to Convert The Rule 12(b)(6) Motion to a Motion for Summary Judgement Conflicts With Rule 12(b), Evidence Rule 201(b) and the Third Circuit.

To satisfy Midcal's second prong, SCE and SDG&E each have the burden to prove: (1) that the CPUC ordered the specific energy efficiency rebate prices as well as other anticompetitive acts complained of by Transphase, (2) the CPUC ordered such a scheme only after a substantial examination, and (3) that the actual prices and conduct carried out by the defendants complied with the CPUC orders. FTC v. Ticor, 112 S.Ct. at 2177 and 2179. See also Patrick v. Burget, 486 U.S. 94, 102, 108 S.Ct. 1658, 1663 (1988). (Active supervision requirement not met where state did not "exer[t] any significant control" over the restraint. "The mere presence of some state involvement or monitoring does not suffice.")

Just what the CPUC did to actively supervise and control the acts complained of is an issue of fact. While the District Court may take judicial notice of the 300-plus pages

of CPUC decisions submitted by SCE under Federal Rules of Evidence 201 (c) and (d), Transphase vigorously contests that CPUC decisions are factually determinative as to CPUC control. Indeed, Transphase alleges that even if the CPUC documents specified the energy efficiency prices (which they do not), the utilities were not in compliance with these hypothetical rate orders. Thus, the CPUC documents cannot factually in and of themselves answer the question of whether the CPUC controls the prices complained of.

In a motion to dismiss, the court must determine whether it appears beyond doubt that the plaintiff could prove no set of facts entitling it to relief. Conley v. Gibson, supra. It is certainly not "beyond doubt" that the CPUC decisions could hypothetically set the energy efficiency rebates and avoided costs, but that in reality the CPUC had little if any control over actual rebates and avoided costs established by the utilities. But in response to the utilities' Motion to Dismiss, Transphase did not just allege a lack of CPUC control, it filed with the District Court publicly available documents and affidavit proving total lack of control by the CPUC.[8]

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[8]See Declaration of Douglas A. Ames Accompanying Submission of Evidence on Second Prong of Midcal test, dated July 9, 1993, ¶1 to 11, and accompanying 12 exhibits (130 pages) demonstrating SCE rebate offers of $0, $100, and $200 per kw, as well as a one time offer of $600 per kw - none of which were with CPUC approval. See SDG&E 1992 DSM Annual Report (establishing variable inducement rebate plan without CPUC control). See "Demand-Side Report" (establishing that SDG&E once offered TES rebates at $300 per kw and then lowered rebate prices to $50 to $200 per kw.) See also Ames Decl., ¶12 to 19, and accompanying exhibits, showing, inter alia, SCE setting DSM

The District Court, while taking judicial notice of CPUC decisions, refused to consider Transphase's counter-evidence by converting the 12(b)(6) motion to dismiss, Fed. R.Civ.P., to a Rule 56 motion for summary judgment. App. 8a to 9a, n. 5. However, Rule 12(b) provides, in part:

> If, on a motion asserting the defense numbered (6) to dismiss for failure of the pleading to state a claim upon which relief can be granted, matters outside the pleading are presented to and not excluded by the court, the motion shall be treated as one for summary judgment and disposed of as provided in Rule 56, and all parties shall be given reasonable opportunity to present all material made pertinent to such a motion by Rule 56. (emphasis added.)

The Ninth Circuit affirmed the District Court's refusal to allow Transphase to present material pertinent if not dispositive to the issue of active regulatory control, in direct violation of Rule 12(b).

The Ninth Circuit also affirmed the District Court's violation of Federal Rule of Evidence 201(b) "Judicial Notice of Adjudicative Facts," by taking judicial notice of 300-plus pages of CPUC documents as factually determinative of CPUC control over the utilities' energy efficiency programs. As made clear in Rule 201's "Notes of Advisory Committee on 1972 Proposed Rules", subdivision (b):

With respect to judicial notice of adjudicative facts,

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avoided capacity costs at $295 per kw while simultaneously setting avoided costs for supply-side solicitations varying between $1350 and $6600 per kw, without CPUC scrutiny.

> **the tradition has been one of caution in requiring that the matter be beyond reasonable controversy..."[T]he appropriate fashion for meeting disputed adjudicative facts includes rebuttal evidence, cross-examination, usually confrontation, and argument (either written or oral or both)." (quoting Professor Davis, "A System of Judicial Notice Based on Fairness and Convenience")**

Whether the utilities' energy efficiency programs were actively controlled by the CPUC was in vigorous controversy, and thus the District Court's taking of judicial notice of this fact violated Evidence Rule 201(b).

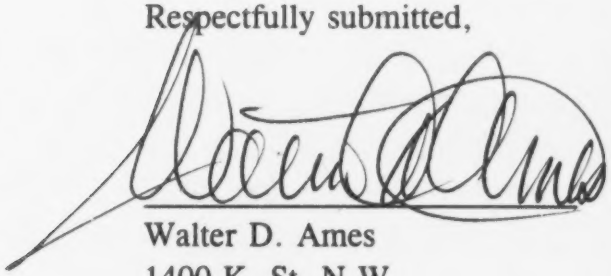
Further still, the District Court's refusal in this case to consider Transphase's material directly conflicts with the Third Circuit in Yeager's Fuel, 22 F.3d at 1272, where the District Court did convert the 12(b)(6) Motion filed by the utility to a Rule 56 Motion for Summary Judgment so that the plaintiff could submit material on Midcal's "active regulatory supervision" prong.

By deciding a genuine issue of material fact on a 12(b)(6) Motion without considering Transphase's submission of publicly available information and material, the Ninth Circuit violated Rule 12(b), Fed.R.Civ.P., Rule 201(b), Fed.R. of Evid., and set itself in conflict with the Third Circuit.

V. CONCLUSION

This petition for writ of certiorari should be granted.

Respectfully submitted,



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September 1, 1994

Counsel for Petitioner

APPENDIX

NOT FOR PUBLICATION

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UNITED STATES COURT OF APPEALS

May 9, 1994

FOR THE NINTH CIRCUIT

TRANSPHASE SYSTEMS, INC.,	)	
	)	
Plaintiff-Appellant,	)No. 93-56550	
	)	
v.	)D.C. No. CV-93-	
	) 02552Kn	
	)	
SOUTHERN CALIFORNIA EDISON	)	
COMPANY; SAN DIEGO GAS &	)	O R D E R
ELECTRIC COMPANY,	)	
	)	
	)	
Defendant-Appellees.	)	
	)	

Appeal from the United States District Court
for the Central District of California
David V. Kenyon, District Judge, Presiding

Argued and Submitted May 3, 1994
Pasadena, California

Before: KOZINSKI, TROTT, Circuit Judges, and WILLIAMS,*

The order of the district court dismissing Transphase

*The Honorable Spencer M. Williams, Senior United States District Judge for the Northern District of California, sitting by designation.

Systems, Inc.'s complaint for failure to state a cause of action (Federal Rule 12(b)(6)) is affirmed for the reasons given by Judge Kenyon in his order of October 7, 1993 discussing the "state action" doctrine enunciated in Parker v. Brown, 317 U.S. 341 (1943) and its progeny.

AFFIRMED.

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

TRANSPHASE SYSTEMS, INC.,	)
	)
Plaintiff,	)
	)
v.	)CV 93-2552 Kn
	) (Ex)
SOUTHERN CALIFORNIA EDISON COMPANY and SAN DIEGO GAS & ELECTRIC COMPANY,	)
	)
Defendants.	)
	)

ORDER GRANTING DEFENDANTS' MOTIONS TO DISMISS

This case comes before the Court on defendants Southern California Edison Company's ("SCE") and San Diego Gas & Electric Company's ("SDG&E") Motions to Dismiss Transphase Systems, Inc.'s federal antitrust claims for failure to state a cause of action pursuant to Federal Rule 12(b)(6). Defendants allege, among other things, that Transphase's antitrust claims are barred by the "state action" doctrine and that SCE and SDG&E's participation in proceedings before the California Public Utilities Commission ("CPUC") is protected conduct under the Noerr-Pennington Doctrine. Defendant SDG&E also asserts that Transphase has failed to allege a claim under the antitrust laws because it has failed to adequately allege that the defendants were significant competitors in the relevant

product market and that their conduct created a dangerous probability that they would monopolize the market.[1] The Court agrees with all of these contentions and therefore GRANTS SCE's and SDG&E's Motions to Dismiss Transphase's antitrust claims with prejudice. The Court also dismisses Transphase's pendent state law claims under the California Unfair Practices Act and the California Cartwright Act. The Court explains its reasoning briefly in the Discussion section below.

I. INTRODUCTION

Plaintiff Transphase Systems, Inc ("Transphase") sells thermal energy storage ("TES") systems designed to shift electricity use from high demand periods (such as hot summer days) when electricity is more expensive to provide to lower demand times, typically at night. Transphase's particular TES system uses cooling tanks containing salt water that is frozen at night. Water is cooled as the tanks defrost during the day and is then circulated through a building's air conditioning system to provide cool air. Transphase's TES system is one of a variety of technologies in "demand-side management" ("DSM") which are designed to promote energy conservation and reduce the need for new power generation by shifting electricity use from high to low demand periods. DSM resources like Transphase's TES system are supposed to benefit ratepayers by offsetting the

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[1]Defendants' motions present several other arguments in favor of dismissing Transphase's complaint, including that Transphase has failed to allege any anticompetitive conduct or antitrust injury suffered by Transphase. Although these arguments are closely related to SDG&E's argument concerning the relevant product market, the Court does not directly address them.

need for utilities to build power plants or buy additional electric capacity from independent power producers at a higher unit cost than the ratepayers would need to pay for the DSM system.

Commercial electricity customers can reduce their electric bills by using Transphase's product to take advantage of lower nighttime off peak electricity rates. The drawback is that Transphase's TES technology is too expensive to make it commercially attractive; the typical commercial electric customer would find the "payback period" needed to recoup his initial capital investment to be too long to justify the initial expense of buying one of Transphase's systems. In order to remedy this problem and promote the use of energy conserving/load management technologies, the CPUC authorizes utility companies like SCE and SDG&E to provide rebates for electricity customers who utilize DSM technology. Both SCE[2] and SDG&E[3] provide such rebates for customers who decide to utilize DSM systems like that marketed by Transphase. The gist of Transphase's complaint is that SCE and SDG&E have conspired with one another and independently used their monopoly power over the energy supply in their respective service areas to hold down the rebate levels awarded to customers who utilize or

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[2]Southern California Edison is one of the largest electric utilities in the United States and distributes and sells electricity to customers within a large segment of Los Angeles County and adjacent counties.

[3]SDG&E is an electric utility based in San Diego which distributes and sells electricity within a large area of Southern California, including San Diego County and portions of Orange County.

desire to utilize DSM systems like that designed by Transphase. Plaintiffs allege that if the defendants had awarded consumers with the appropriate sized rebates, more customers would decide to buy TES systems and the value of Transphase's business would have increased by more than $50 million above its present value.

Transphase alleges two violations of Section 2 of the Sherman Act: Actual Monopolization (Comp. at ¶¶ 19-27) and Attempted Monopolization, including a conspiracy to attempt monopolization. In addition, Transphase also alleges a combination by SCE and SDG&E to restrain trade in violation of Section 1 of the Sherman Act. (Comp. at ¶¶ 40-43).

Transphase's actual monopolization claim alleges that the defendants enjoy monopoly power by "virtue of their ability to determine the prices of thermal energy storage systems and the electricity savings provided thereby to both the host customer and the DSM ratepayers." (Comp. at ¶ 20). Transphase contends that the defendants have willfully acquired and maintained their monopoly power over the "TES retrofit and DSM resources" by (1) "arbitrarily establish[ing]" rebates by refusing to consider new power plants when determining "avoided costs" and "manipulating" avoided costs; (2) controlling the amount of DSM funds to be budgeted for TES; and (3) controlling the "measuring and verifying" of whether the projected DSM savings are actually acquired. (Comp. at ¶¶ 20-22). In addition, the defendants are also accused of "actively resisting" competitive bidding between DSM and supply side options and thus preventing Transphase from competing directly against proposals to build additional generating facilities. Id. at ¶22.

Transphase's Section 1 conspiracy claim alleges that the defendants have "conspired to restrain trade by establishing artificially low rebate levels for TES" and by establishing different measurement standards for themselves than those to be applied to independent DSM suppliers. In particular, Transphase alleges that the defendant utilities have "combined and conspired to restrain commerce among the various states by deliberately adjusting their avoided costs" and "appearing together before regulatory and other bodies" to oppose joint bidding between suppliers of supply-side management (SSM) and suppliers of DSM services like Transphase. (Comp. at ¶¶ 40-43.)

II. DISCUSSION

A. State Action Doctrine

Defendants contend that Transphase's antitrust claims are totally barred by the "state action" doctrine enunciated in Parker v. Brown, 317 U.S. 341 (1943). The state action doctrine places state sponsored restraints on competition beyond the reach of the Sherman Act in order to promote the principles of federalism and state sovereignty. City of Columbia v. Omni Outdoor Advertising, Inc., 111 S.Ct., 1344, 1349 (1991). The Supreme Court has set forth a two-pronged test for determining when actions taken by private parties, pursuant to a state regulatory regime, are immunized by the state action doctrine. First, the Court must determine whether the challenged restraint is "one clearly articulated and affirmatively expressed as state policy." Southern Motor Carriers Rate Conf. v. U.S., 471 U.S. 48, 57 (1985)(quoting Lafayette v. Louisiana Power & Light Co., 435 F.2d 389, 410 (1978). Secondly, "the State must supervise actively any private anticompetitive conduct." Southern Motor

Carriers, at 57 (citing California Retail Liquor Dealers Assn v. Midcal Aluminum, Inc., 445 U.S. 97, 105 (1980)).[4] This supervision requirement is only satisfied "if state officials have and exercise power to review particular anticompetitive acts of private parties and disapprove those that fail to accord with state policy." Patrick v. Burget, 486 U.S. 94, 101 (1988).

After a thorough analysis of the complaint, the parties' briefs and documentary exhibits, the relevant sections of the California Public Utility Code, and the published opinions of the CPUC, the Court finds that both prongs of the Midcal test have been satisfied and, accordingly, holds that the defendants' allegedly anticompetitive actions are immunized by the state action doctrine.

Transphase's complaint alleges that defendants engaged in two basic anticompetitive acts: (1) failing to directly compare TES cost savings with the cost of supplying more electricity; and (2) suppressing both the total funds available for rebate subsidies and the rebate levels themselves. The CPUC decisions[5] cited by SCE and SDG&E clearly

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[4]This second prong of the Midcal test prevents the State from frustrating the national policy in favor of competition by casting a 'gauzy cloak of state involvement' over what is essentially private anticompetitive conduct." Southern Motor Carriers, at 57 (citing Midcal, 445 U.S. at 106).

[5]Transphase objects to the defendants' submission of and citations to these reported CPUC decision and asserts that, if the Court decides to consider these decisions, defendants' motions would be transformed into motions for summary judgment, pursuant to Rule 56. The Court disagrees. The Court may take judicial notice of these decisions under Federal Rule of Evidence

establish, however, that the form and extent of ratepayer funding for all DSM programs, including SCE's and SDG&E's, has been closely scrutinized, repeatedly modified, and ultimately approved by the CPUC.

1. California Has a "Clearly Articulated and Affirmatively Expressed" Policy to Displace Competition with Respect to DSM Bidding and the Ratemaking Process

The Court's review of the California Public Utilities Code reveals that the California legislature has clearly articulated and expressed its desire to displace competition with respect to DSM bidding and the ratesetting process. Section 747 of the Public Utilities Code sets up a legislatively mandated bidding system for demand side

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201(e) since their existence is a fact "capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned." Fed.R.Evid. 201(e). The Ninth Circuit held in Nugget Hydroelectric v. Pacific Gas and Electric, 981 F.2d 429, 435 (9th Cir. 1992), that a district court could take published decisions of the CPUC into account on a motion to dismiss in order to determine whether the State had "actively supervised" a defendant's allegedly anticompetitive conduct. The Nugget court ultimately found that the CPUC decision at issue, together with the applicable Guidelines, were sufficient to prove that the state actively supervised the defendant's conduct, thus satisfying the second prong of the Midcal test.

The Court therefore finds that it may properly consider the reported decisions of the CPUC in the context of the defendants' motion to dismiss. Since the Court's consideration of these decisions does not transform this into a motion for summary judgment under Rule 56, the Court DENIES Transphase's request to submit evidence on the second, "active supervision" prong of the Midcal test.

services and mandates that the CPUC should establish a pilot program of "competitive bidding auctions for demand side services." Other sections of the code, see e.g., § 701.1(c), set forth the criteria for determining the proper rebate for DSM services and prohibit the CPUC from changing any rate or altering "any classification, contract, practice, or rule as to result in a new rate, except upon a showing before the Commission and a finding by the Commission that the new rate is justified." Cal. Pub. Util. Code § 454(a). Taken as a whole, the Public Utility Code clearly articulates the state's policy of displacing competition in favor of a highly regulated system of ratesetting and bidding on alternative DSM systems.

2. The CPUC Has "Actively Supervised" SCE's and SDG&E's DSM Activities

Transphase's complaint alleges that defendants SCE and SDG&E control almost every aspect of the DSM ratesetting and bidding processes in their respective geographic markets. Transphase alleges, for example, that the defendants (1) have the power to decide whether DSM vendors like Transphase should be permitted to bid directly against supply side alternatives that can generate their own electric power (Comp. at ¶ 20); (2) determine the amount of DSM funds to be budgeted for TES systems like Transphase's (Comp. at ¶ 20); and (3) decide the ways in which "electricity savings projected from DSM technologies are measured and verified." Id. Finally, Transphase alleges that the defendant utilities "choose to conduct" the rebate programs and that "ratepayers cannot negotiate directly with Transphase, which must deal with the ratepayers through the utilities." (Comp. at ¶ 15).

The reported decisions of the CPUC and the relevant sections of the California Utilities Code clearly establish that all of these allegations are false and unsupportable as a matter of law. In fact, the CPUC, not the defendant utilities, have the sole authority to (1) decide whether DSM vendors should be permitted to bid directly against supply side alternatives[6]: (2) establish the amount of DSM funds to be budgeted for TES systems[7]; and (3) decide the ways in which electricity savings derived from DSM systems are measured and verified[8]. Moreover, the rebates provided to Transphase's customers are derived from ratepayer funds and cannot be collected or disbursed without the CPUC's explicit approval. Cal. Pub. Util. Code §§ 451, 454. Transphase's sweeping allegations about the control exercised by the defendants are thus totally unfounded. Rather, a careful review of the CPUC's published opinions clearly establishes that the Commission actively supervises every aspect of SCE and SDG&E's DSM activities attacked by Transphase's complaint.

For the preceding reasons, the Court finds that the anticompetitive actions alleged to have been committed by defendants SCE and SDG&E in Transphase's complaint are immunized from federal antitrust liability by the "state action" doctrine.

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[6]Indeed, the CPUC recently decided, after Transphase filed this complaint, to set up direct bidding between demand and supply side alternatives.

[7]See 1988 GRC at 475-477; 1992 GRC at 144.

[8]See Interim DSM Bidding Pilots at 22.

B. Defendants' Actions Are Immunized by the Noerr-Pennington Doctrine

The defendants also assert that the "anticompetitive acts" which they are alleged to have committed by Transphase's complaint are protected by the Noerr-Pennington doctrine. The Noerr-Pennington doctrine protects the right of parties to petition the government even if the impact of their position is likely to have an anti-competitive effect. Franchise Realty Interstate Corp. v. San Francisco Local Joint Exec. Bd., 542 F.2d 1076, 1080-81 (9th Cir. 1976), cert. denied, 430 U.S. 940, at 1080 (1977) ("Joint efforts to influence public officials do not violate the antitrust laws even though intended to eliminate competition.")

As noted above, Transphase has alleged that the defendants violated Section 1 of the Sherman Act by (1) appearing together before the CPUC to take positions that would disadvantage Transphase; (2) filing joint briefs before the CPUC; and (3) speaking "in unison before [the CPUC] to demand the fruits of their monopolies." These actions are clearly protected by the Noerr-Pennington doctrine and therefore cannot form the basis for a conspiracy claim under Section 1.

Transphase's claims for monopolization and attempted monopolization under Section 2 of the Sherman Act are also protected by the Noerr-Pennington doctrine. Transphase alleges that the defendants have maintained their monopoly power by "resisting meaningful changes" to their rebate programs and resisting competitive bidding between DSM and Supply Side options. Although the complaint does not explicitly describe how defendants resisted these changes, it is clear from the context of the allegations, that the

defendants' alleged resistance was exercised by the defendants through the public positions they took in the CPUC proceedings. Thus, Transphase's claims under Section 2 of the Sherman Act are also barred by the Noerr-Pennington doctrine.

Transphase alleges in its Opposition to both SCE and SDG&E's Motions that it is relying on the "sham" exception to the Noerr-Pennington doctrine, but Transphase has failed to plead anywhere in its complaint that the defendants' conduct before the CPUC was a "sham". Thus, Transphase's complaint must be dismissed. The Ninth Circuit has held that "a complaint must include allegations of the specific activities, not protected by Noerr, which plaintiffs contend have barred their access to a governmental body." Franchise Realty, supra, 542 F.2d at 1082. Transphase has failed to meet this demanding pleading standard.

Transphase asserts in its Opposition, however, that it should be provided an opportunity to amend its complaint to allege that the defendants' actions before the CPUC were a "sham". The "sham exemption" does not appear to extend to direct lobbying efforts seeking action by an administrative body (like the CPUC), however. Franchise Realty, at 1080. Therefore, Transphase's request to amend its complaint by alleging that defendants' conduct was a "sham" would be futile.

The Court thus finds that Transphase's antitrust claims against the defendants are barred by the Noerr-Pennington doctrine.

C. Defendants SCE and SDG&E are Not Significant Competitors in the Relevant Product Market

It is axiomatic in antitrust law that a defendant may not be found liable under the Sherman Act for monopolizing or attempting or conspiring to monopolize a market unless that defendant is a competitor in the relevant market and his conduct creates a dangerous probability that he will gain a dominant share of the market. Spectrum Sports, Inc. v. McQuillan, 113 S.Ct. 884, 890-91 (1993);Mercy-Penninsula Ambulance v. County of Mateo, 791 F.2d 755, 759 (9th Cir. 1986) (county government, which performed no health care services, could not be charged with having used its market power to exclude competition when it refused to license an ambulance service because it was not a competitor in the relevant product market). Defendant SDG&E contends that it cannot be found to have violated the Sherman Act because it is not a competitor in the relevant product market and Transphase's complaint neither alleges that SDG&E is a competitor in the relevant market nor that it's conduct creates a dangerous probability that it will monopolize that market.[9]

Transphase claims that the relevant product market "over which" the utilities exercise their monopoly power are broadly speaking, DSM resources, and with specific respect to Transphase, retrofit thermal energy storage (TES) goods and services" like those supplied by plaintiff. (Comp. at ¶ 17). SDG&E asserts, however, that Transphase acknowledges in its complaint that SDG&E and SCE are not

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[9]Although SCE does not present this argument in its own motion to dismiss, the Court finds that this argument is applicable to SCE as well as SDG&E and thus dismisses Transphase's antitrust claims against SDG&E and SCE on the grounds presented in SDG&E's motion and Section C above.

really competitors in this product market; they merely exercise control over the DSM goods and services provided by others by virtue of their alleged power to control the bidding programs and rebate levels for those services. The Court agrees with SDG&E's argument and therefore GRANTS its Motion to Dismiss on these grounds.

Transphase's complaint clearly states that while SDG&E and SCE "have a monopoly over the furnishing of [DSM systems and, specifically, Transphase's TES services] to the ratepayers. . .[they] are not themselves capable of supplying those goods and services to the ratepayers, only of preventing Transphase from so doing." (Comp. at ¶ 19) (emphasis added). In another paragraph, Transphase again alleges in a conclusory fashion that the defendants have monopolies over the provision of DSM services and have "willfully maintained" these monopolies; Transphase concedes in the very next phrase, however, that the utilities "basically do nothing to supply such DSM resources to the ratepayers of California but hire others and charge large administrative costs and profits" to do so. (Comp. at ¶ 25). Transphase has also failed to allege that either SDG&E or SCE has significant market share in either the provision of DSM systems or in the TES systems marketed by Transphase.

Although the Court must assume that the allegations in a plaintiff's complaint are true when considering defendants' motion to dismiss, N.L. Industries, Inc. v. Kaplan, 792 F.2d 896, 898 (9th Cir. 1986), the Court does not "need to accept as true conclusory allegations. . .or unreasonable inferences." Schwarzer, Tashima, and Wagstaffe, Federal Civil Procedure Before Trial, § 9:221 at page 9-41. The

Court thus rejects Transphase's conclusory allegations of the defendants' market power within the relevant product market (as opposed to geographic market) since these allegations are directly contradicted by Transphase's unambiguous admission that the utilities "do nothing to supply such DSM resources to the ratepayers of California but hire others" to supply these systems. (Comp. at ¶ 25) (emphasis added). Although Transphase alleges in its Opposition that "[c]urrently, SDG&E directly provides DSM resources to its ratepayers" and that Transphase "would never intimate that the defendant utilities are incapable of hiring someone to install" TES systems (Opposition at pages 14-15), the complaint itself clearly fails to allege either that (1) SDG&E or SCE competes with Transphase in the supply of DSM or TES systems; or (2) that the defendants' current activities create a dangerous probability that they will obtain a monopoly over, or even a dominant position, in the relevant product market. Transphase's complaint therefore fails to plead an actionable claim under the federal antitrust statutes.[10]

III. CONCLUSION

For the reasons discussed above, the Court GRANTS Defendants' Motions to Dismiss Transphase's federal

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[10]If there were no independent basis for dismissing Transphase's complaint, the Court would allow plaintiff leave to amend its complaint in the event that it could, in good faith, plead that the defendants are competitors in the supply or distribution of DSM or TES systems. Given that the Court has also decided to dismiss Transphase's antitrust claims on two independent grounds, however, the Court does not grant Transphase leave to amend at this time.

antitrust claims. The Court also dismisses Transphase's pendent state law claims since all of plaintiff's federal claims have been dismissed. See Les Shockly Racing, Inc. v. National Hot Rod Ass'n, 884 F.2d 504, 509 (9th Cir. 1989).

IT IS SO ORDERED.

DATED: October 7, 1993

/s/David V. Kenyon
DAVID V. KENYON
UNITED STATES DISTRICT JUDGE

NOT FOR PUBLICATION

Filed Stamp

UNITED STATES COURT OF APPEALS

June 9, 1994

FOR THE NINTH CIRCUIT

TRANSPHASE SYSTEMS, INC.,	)	
	)	
Plaintiff-Appellant,	)	No. 93-56550
	)	D.C. No.
v.	)	93-02552Kn
	)	
SOUTHERN CALIFORNIA EDISON COMPANY; SAN DIEGO GAS & ELECTRIC COMPANY,	)	O R D E R
	)	
Defendant-Appellees	)	

Before: KOZINSKI, TROTT, Circuit Judges, and WILLIAMS,*

The panel as constituted in the above case has voted to deny the petition for rehearing and to reject the suggestion for a rehearing en banc.

The full court has been advised of the suggestion for en

*The Honorable Spencer M. Williams, Senior United States District Judge for the Northern District of California, sitting by designation.

banc rehearing, and no judge of the court has requested a vote on the suggestion for rehearing en banc. Fed. R. App. P. 35(b).

The petition for rehearing is denied and the suggestion for a rehearing en banc is rejected.

Additional California Statutory Provisions:

Public Utilities Code § 744.7 (1993).

Cooperative programs with customers to reduce energy bills and regulate energy quality:

(e) It is the intention of the Legislature that in reviewing and supervising programs authorized by this section, and in establishing the level of direct and indirect general ratepayer support to be used in these programs the commission shall pursue the public benefits of these programs consistent with the policies expressed in Chapter 984 of the Statutes of 1983. The Legislature further intends that the commission shall, in determining whether and to what extent direct and indirect general ratepayer support may be used in these programs, exercise its regulatory and supervisory powers to promote a competitive marketplace for energy efficiency equipment and services. The commission's findings concerning general ratepayer support of those programs, and its determination that those programs are consistent with the policies expressed in Chapter 984, shall be determinative of those issues unless found to be arbitrary and capricious. However, nothing in this subdivision is intended to affect any litigation commenced prior to July 1, 1993. Nothing in this section shall prevent the commission from utilizing a competitive bidding process for all or any part of the work to be performed under these programs.

CHAPTER 1369

CALIFORNIA STATUTES OF 1990:

An act to add Sections 746, 747, and 747.5 to the Public Utilities Code, relating to public utilities.

The people of the State of California do enact as follows:

SECTION 1. The Legislature hereby finds and declares the following:

(a) The maintenance and expansion of existing utility conservation programs, and the adoption of new conservation programs, could contribute significantly to the successful implementation of a long-term, least-cost energy plan for the citizens of California.

(b) To promote additional energy conservation measures, the Public Utilities Commission should provide an opportunity for conservation to compete on a fair and reasonable basis with generating resources to fulfill future utility resources needs.

(c) To promote additional utility financed conservation programs, the Public Utilities Commission should establish a pilot program to provide incentives for utilities to invest in conservation programs.

[Section 2 is omitted]

SEC. 3. Section 747 is added to the Public Utilities Code, to read:

§747. (a) In addition to the incentives program required by Section 746, the commission shall require one or more electric utilities to implement pilot projects to accomplish the

following:

(1) On or before June 30, 1991, begin to test separately from any generation resource bidding system the ability of demand side bidding to deliver benefits to utility customers.

(2) At the earliest practicable time, test the feasibility of an integrated bidding system that includes both generation resources and demand side programs.

(b) The commission shall establish a pilot program for gas utilities which tests a program of competitive bidding auctions for demand side services which deliver benefits to utility customers. However, a pilot program shall not apply to customer classes for which the gas utility is at risk for loss of sales or revenues due to the lack of a sales adjustment mechanism.

(c) At the earliest practicable time, the commission, in consultation with the State Energy Resources Conservation and Development Commission, shall report the results of the pilot projects required by subdivisions (a) and (b) to the Legislature. The report shall assess the feasibility and implications of implementing the tested bidding systems and shall include recommendations on whether or not the state should adopt either, or both, of the following:

(1) An integrated bidding system that allows demand side services to compete with generation resources to fulfill future electric utility resource needs, or a program of separate bidding auctions for demand side services which deliver benefits to electric utility customers.

(2) A program of separate bidding auctions for demand side services which deliver benefits to natural gas utility customers.

§454. Rate increases; Establishment of rules as to showing required to support proposed increases; Testimony by customers

(a) Except as provided in Section 454.1 and 455, no public utility shall change any rate or so alter any classification, contract, practice, or rule as to result in any new rate, except upon a showing before the commission and a finding by the commission that the new rate is justified. Whenever any electrical, gas, heat, telephone, water, or sewer system corporation files an application to change any rate, other than a change reflecting and passing through to customers only new costs to the corporation, which do not result in changes in revenue allocation, for the services or commodities furnished by it, the corporation shall furnish to its customers affected by the proposed rate change notice of its application to the commission for approval of the new rate. This notice requirement does not apply to any rate change proposed by a corporation pursuant to an advice letter submitted to the commission in accordance with the commission procedures for this means of submission...Enacted 1951. Amended Stats. 1961, ch. 943, §1, p. 2574; Stats. 1973, ch. 1105, §1; Stats. 1974, ch 194, §1, effective April 30, 1974; Stats. 1975, ch. 518, §1; Stats. 1976, ch. 835, §1; Stats. 1984, ch. 1498, §4, effective September 27, 1984; Stats. 1988, ch. 108, §1.

Historical Derivation:

(a) Stats. 1915, ch. 91, §63, subd (a), p. 159.

(b) Stats. 1st Ex Sess 1911, ch. 14, §63, subd.(a), p. 53.

§ 701.1 Legislative findings; Inclusion of value for costs and benefits to environment in cost effectiveness calculations; Powerplant bid solicitation.

(a) The Legislature finds and declares that, in addition to other ratepayer protection objectives, a principle goal of electric and natural gas utilities' resource planning and investment shall be to minimize the cost of society to the reliable energy services that are provided by natural gas and electricity, and to improve the environment and to encourage the diversity of energy sources through improvements in energy efficiency and development of renewable energy resources, such as wind, solar, biomass, and geothermal energy.

(b) The Legislature further finds and declares that, in addition to any appropriate investments in energy production, electrical and natural gas utilities should seek to exploit all practicable and cost-effective conservation and improvements in the efficiency of energy use and distribution that offer equivalent or better system reliability, and which are not being exploited by any other entity.

(c) In calculating the cost effectiveness of energy resources, including conservation and load management options, the commission shall include, in addition to other ratepayer protection objectives, a value for any costs and benefits to the environment, including air quality. The commission shall ensure that any values it develops pursuant to this section are consistent with values developed by the State Energy Resources Conservation and Development Commission pursuant to Section 25000.1 of the Public Resources Code. However, if the commission determines that a value developed by the State Energy Resources

Conservation and Development Commission pursuant to subdivision (c) of Section 25000.1 of the Public Resources Code, the commission may nonetheless use this value if, in the appropriate records of its proceedings, it states its reasons for using the value it has selected.

[Subsections "d" through "i" omitted.]

No. 94-394

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1994

Transphase Systems, Inc.
Petitioner,

v.

Southern California Edison Company and
San Diego Gas & Electric Company
Respondents.

On Petition for a Writ of Certiorari
to the United States Court of Appeals
for the Ninth Circuit

BRIEF FOR RESPONDENT SAN DIEGO GAS & ELECTRIC COMPANY IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the "state action" doctrine is applicable to protect private defendants in the context of a civil action brought by a private plaintiff under Sherman Act § 2.

2. Whether the courts below correctly concluded that the State of California has a "clearly articulated and affirmatively expressed" state policy to displace "unfettered business freedom" with regulation in the provision of Demand-Side Management services, sufficient to satisfy the *Midcal* test.

3. Whether the district court correctly declined plaintiff's request to convert defendants' Rule 12(b)(6) motions to dismiss into Rule 56 motions for summary judgment.

PARTIES TO THE PROCEEDINGS

The caption of the case contains the names of all parties.

San Diego Gas & Electric Company ("SDG&E") is an investor-owned public corporation. SDG&E has one subsidiary that is not wholly owned: Califia Company. One of SDG&E's wholly owned subsidiaries, Pacific Diversified Capital Company, has one subsidiary that is not wholly owned: Wahlco Environmental Systems, Inc.

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No. 94-394

IN THE

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OCTOBER TERM, 1994

Transphase Systems, Inc.
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Respondents.

On Petition for a Writ of Certiorari
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for the Ninth Circuit

BRIEF FOR RESPONDENT SAN DIEGO GAS & ELECTRIC COMPANY IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-2a) is unreported. The opinion of the district court (Pet. App. 3a-17a) is reported at 839 F. Supp. 711.

JURISDICTION

The judgment of the court of appeals was entered on May 9, 1994. The petition for rehearing, and suggestion for rehearing *en banc*, was denied on June 9, 1994 (Pet. App. 18a-19a). The petition for writ of certiorari was filed on September 1, 1994. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATEMENT OF THE CASE

A. Proceedings Below

Petitioner Transphase Systems, Inc. ("Transphase") filed this action accusing respondents, two electric utilities serving separate regions in southern California, of monopolization and attempted monopolization of the market for Demand-Side Management ("DSM") services related to the use of electricity, and conspiracy to monopolize this same market. Petitioner asserted claims under Sherman Act §§ 1 and 2, 15 U.S.C. §§ 1, 2; and the California Cartwright Act, Cal. Bus. & Prof. Code §§ 16700 to 16770 (West 1987).

On July 12, 1993, respondents filed separate motions to dismiss petitioner's complaint. The district court granted respondents' motions on three separate grounds. First, the court held that petitioner's complaint was barred in its entirety by the "state action" doctrine, as enunciated in *Parker* v. *Brown*, 317 U.S. 341 (1943), and its progeny. The district court ruled that California had a clearly articulated and affirmatively expressed state policy to displace competition with respect to DSM bidding and the ratesetting process, and that the California Public Utilities Commission ("CPUC") has actively supervised respondents' DSM activities. (Pet. App. 9a-11a)

Second, the court held that petitioner's antitrust claims were also barred by the *Noerr/Pennington* doctrine.[1/] Specifically, the court ruled that petitioner's claims that respondents appeared together before the CPUC, filed joint briefs before the CPUC, and "resisted meaningful changes" to the CPUC-mandated rebate programs and bidding systems affecting the provision of DSM products, fell squarely within the protection provided by *Noerr/Pennington*. (Pet. App. 12a-13a)

Third, the district court ruled that petitioner's claims were barred because petitioner had failed to allege any facts showing that respondents were significant competitors in the product market alleged to be monopolized. (Pet. App. 13a-16a) The

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[1/] *See United Mine Workers* v. *Pennington*, 381 U.S. 657 (1965); *Eastern R.R. Presidents Conf.* v. *Noerr Motor Freight*, 365 U.S. 127 (1961).

district court also noted, but did not rule upon, respondent-SDG&E's argument that Transphase had failed to allege any anticompetitive conduct by the utilities or any antitrust injury. (Pet. App. 4a n.1)[2/]

The court of appeals affirmed in an unpublished order, stating that the district court's dismissal of petitioner's complaint for failure to state a cause of action was affirmed for the reasons set out in the district court's opinion relating to the state-action doctrine. (Pet. App. 1a-2a)

B. Statement of the Facts

Both SDG&E and Southern California Edison ("SCE") are utilities that generate, distribute, and sell electric energy. As a result of regulatory policies of the State of California, each utility has a monopoly in the distribution and sale of electricity in its own service territory. Petitioner Transphase conceded in its complaint that respondents' monopoly in this respect is protected under the state-action doctrine as enunciated by this Court in *Parker* v. *Brown* and its progeny. (Compl. ¶ 32) Transphase's complaint instead dealt with DSM, which refers broadly to efforts to reduce system-wide electrical demand. DSM can in theory reduce both the capacity and energy demands of electric consumers, which can in turn reduce the need for utilities to construct new generating plants.

Transphase sells a thermal energy storage ("TES") system, one type of DSM, designed to shift electricity usage from high-demand periods ("peak" periods) when electricity is more expensive, typically at mid-day, to low-demand periods ("off-peak" periods), typically at night. The type of TES system produced by Transphase consists of special water storage tanks and related equipment which allow the customer to operate its electric chiller -- used to cool water for air conditioning -- during the night rather than the day. The chilled water is then

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[2/] At the time the district court dismissed the complaint, Transphase had pending a motion for a preliminary injunction to enjoin two CPUC-mandated Requests for Bid through which respondents were seeking to fill certain of their projected electricity needs. Transphase's motion was mooted by dismissal of its complaint, without any ruling on that motion.

used during the daytime "peak" hours to provide the necessary air conditioning.

By using the Transphase TES system to take advantage of lower "off-peak" electrical rates, commercial electricity customers can lower their electric bills. The problem with Transphase's TES system is that it is too expensive to be commercially attractive; the time over which the cost of the system is recouped in reduced electrical bills is too long to justify the customer's initial expense of installing the system.

In an attempt to remedy such problems, and to promote the use of DSM resources, the CPUC has developed and supervises a program of subsidies, in the form of rebates, for electricity customers that utilize TES or other types of DSM products. Both SDG&E and SCE are authorized to provide such rebates if use of the particular DSM system by a customer meets the criteria set out by the CPUC. The state legislature has also instructed the CPUC to explore the possibility of combining the "bidding" process by which a service area's projected power needs are filled by including both DSM and supply-side management ("SSM") services -- such as new power plants or cogeneration facilities -- in one bidding process.

The main thrust of Transphase's complaint was that the SDG&E and SCE subsidy programs have been insufficiently generous. Transphase alleged that if the respondent utilities had provided more money through the subsidy programs to Transphase's potential customers, it would have sold more of its TES systems. Transphase alleged that the utilities' failure to provide sufficient subsidies to make its systems economically viable constituted a willful maintenance of their monopoly power over "TES retrofit and DSM resources," in violation of Sherman Act § 2. Transphase also claimed that the utilities had "actively resisted" competitive bidding between DSM and SSM options and thus prevented Transphase from competing directly against proposals to build additional generating facilities.

Transphase's Sherman Act § 1 claim, which Transphase abandoned in its appeal to the Ninth Circuit, rested upon allegations that the utilities "conspired" to restrain trade by establishing artificially low rebate levels for TES and establishing measurement standards for themselves different

from those applied to independent DSM providers. Transphase also alleged that the utilities had conspired to appear together before the CPUC to oppose joint bidding of DSM and SSM resources.

REASONS FOR DENYING THE WRIT

The court of appeals' unpublished decision below is correct, entirely in accord with the decisions of this Court, and not in conflict with any decision of another court of appeals. In addition, the district court's ruling rested upon several alternative grounds, any one of which is sufficient to support the judgment. The petitioner's purported distinction between application of the state-action doctrine to Sherman Act § 1 and § 2 claims was not properly raised or ruled upon below, and lacks any legal basis. Petitioner's objections as to whether California has a clearly articulated policy to displace competition in the area of DSM resources is not only without merit, but also presents no legal issue of general importance and represents a straightforward application of well-established law. Petitioner's objection to the district court's refusal to convert respondents' motions to dismiss into motions for summary judgment is similarly meritless and a fact-bound application of well-established legal principles.

I. THE PETITIONER'S PURPORTED DISTINCTION BETWEEN APPLICATION OF THE STATE-ACTION DOCTRINE TO SHERMAN ACT § 1 AND § 2 CLAIMS WAS NOT ADDRESSED BY THE COURTS BELOW AND HAS NO LEGAL BASIS.

A. Neither the District Court Nor the Court of Appeals Addressed Petitioner's Theory.

The district court, after carefully considering the arguments made by all parties in the context of respondents' motions to dismiss, correctly ruled that the state-action doctrine as a matter of law protected respondents from antitrust liability because: (1) California has a clearly articulated and affirmatively expressed policy to displace competition with respect to DSM bidding and the ratemaking process; and (2) the CPUC has actively supervised respondents' DSM activities.

Transphase now argues that the state-action doctrine does not apply to private defendants in the context of a Sherman Act § 2 claim. As an initial matter, this issue was not addressed by either the district court below, or by the Ninth Circuit in its summary affirmance of the district court's dismissal of Transphase's complaint. Transphase in fact did not even raise this issue at the district court level in its opposition to respondents' motions to dismiss, although it did raise a variation of the argument in a footnote in its motion for a preliminary injunction, which was never ruled upon by the district court and mooted by the dismissal of Transphase's complaint.

This Court generally does not consider issues that have not been decided by either of the courts below. *See, e.g., Moor* v. *County of Alameda*, 411 U.S. 693, 696 n.3 (1973); *Larson* v. *Domestic & Foreign Commerce Corp.*, 337 U.S. 682, 685 (1949). For that reason alone, Transphase's petition for a writ should be denied as to the first question presented by the petition.

B. The Decisions of this Court Do Not Support Petitioner's Theory.

Even if the Court chooses to reach the substantive issue raised by Transphase in its first question, however, it is clear on its face that the distinction Transphase seeks to draw between application of the state-action doctrine to Sherman Act § 1 and § 2 claims is meritless, and has no basis in either the history or purpose of the state-action doctrine.

In *Parker* v. *Brown*, 317 U.S. 341 (1943), the case in which the Court first enunciated the state-action principle, this Court held that state officials could not be held liable under the Sherman Act for implementing a state-mandated agricultural marketing program that restricted competition among growers and maintained prices in the distribution of their commodities to distributors. In so ruling, the Court stated that this so-called "state action" immunity was based upon principles of federalism and state sovereignty. *Parker*, 317 U.S. at 350-51.

Parker v. *Brown* involved a suit against state officials, but the Court subsequently recognized that the foundations of federalism and state sovereignty upon which the state-action doctrine was based required that it also protect anticompetitive actions of a private party that can be attributed to a state's "clearly articulated state policy." *See Southern Motor Carriers Rate Conference, Inc.* v. *United States*, 471 U.S. 48, 59-60 (1985). *See also California Retail Liquor Dealers Ass'n* v. *Midcal Aluminum, Inc.*, 445 U.S. 97, 105 (1980) (setting out the two prong standard of a "clearly articulated" state policy to displace competition, and "active supervision" of the implementation of that policy). As the Court explained in *Southern Motor Carriers*, if state-action immunity were limited to actions by public officials, the ability of states to regulate their domestic commerce would be frustrated, because any program implemented by a state that restrained competition could be stymied by a suit brought against the regulated parties. *Id.* at 56. *See also Patrick* v. *Burget*, 486 U.S. 94, 100 (1988) ("If the Federal Government or a private litigant always could enforce the Sherman Act against private parties, then a State

could not effectively implement a program restraining competition among them").[3/]

The distinction Transphase seeks to draw between claims under Sherman Act § 1, such as price fixing, and claims under Sherman Act § 2, such as monopolization, has no basis either in the case law of this Court or in the principles underlying the state-action defense. As an initial matter, this Court has *never* distinguished between claims under Sherman Act § 1 and § 2 for purposes of applying the state-action doctrine. Indeed, contrary to Transphase's assertions, this Court has applied the doctrine to private defendants in a case involving alleged violations of Sherman Act § 2. In *Patrick* v. *Burget*, *supra*, the plaintiff-physician alleged claims under both Sherman Act § 1 and Sherman Act § 2. This Court applied the state-action doctrine to all of plaintiff's claims, without differentiating between the § 1 and § 2 claims (although ultimately ruling that defendants were not protected because the "active supervision" prong of the *Midcal* test was not met). *Patrick*, 486 U.S. at 105.

In addition, the principles of federalism and state sovereignty that underlie the state-action doctrine apply with equal force whether a claim is brought under Sherman Act § 1 for a conspiracy in restraint of trade or Sherman Act § 2 for monopolization. Just as a state may mandate a system of price controls that, absent state oversight and approval, amounts to price fixing under Sherman Act § 1, so a state may determine that it is in the interests of its citizens that "unfettered" competition in a given industry or segment of an industry be replaced by a system of regulation that gives rise to a "monopoly" under Sherman Act § 2. In either case, "[i]t is the state which has created the machinery" for establishing the program of regulation, and "the state, acting through the Commission, which adopts the program and enforces it . . . ." *Parker*, 317 U.S. at 352.

[3/] Transphase relies heavily upon language in *Cantor* v. *Detroit Edison Co.*, 428 U.S. 579 (1976), in which the Court voiced some uncertainty as to the applicability of the state-action doctrine to private parties. The Court resolved this uncertainty in *Southern Motor Carriers*.

Indeed, as noted above, Transphase conceded in its complaint that the utilities' state-mandated monopolies in the distribution and sale of electricity in their respective service territories are protected by the state-action doctrine. If Transphase's theory were correct, the utilities would also be open to attack under Sherman Act § 2 for monopolization in the distribution and sale of electricity.

Transphase's argument that applying the state-action doctrine to private defendants in the context of a Sherman Act § 2 claim somehow conflicts with the Supremacy Clause is meritless. Congress does, of course, have the power under the Supremacy Clause to preempt a conflicting state law. But this Court expressly held in *Parker* that Congress did not intend the Sherman Act to preempt the authority of the states to regulate local business activities. *Parker*, 317 U.S. at 350-51 ("We find nothing in the language of the Sherman Act or in its history which suggests that its purpose was to restrain a state or its officers or agents from activities directed by its legislature.").

Finally, Transphase's claim that *City of Columbia* v. *Omni Outdoor Advertising, Inc.*, 499 U.S. 365 (1991), stands for the proposition that state-action immunity is only available to state entities in the Sherman Act § 2 context is a serious misreading of that case. In *City of Columbia*, the Court was not faced with a challenge to conduct of private defendants taken pursuant to a state-mandated regulatory regime, as is the case in this action. Rather, the activities that formed the basis of the plaintiff's complaint against the private defendant in *City of Columbia* were its efforts to convince a municipal body to adopt an anticompetitive ordinance. *Id.* at 368. That type of lobbying activity clearly cannot be immunized by the state-action doctrine, because it is not taken pursuant to any type of regulatory mandate from the state. It is, however, petitioning activity that falls under the protection of the *Noerr/Pennington* doctrine, as this Court held. The decision contains no suggestion, however, that the state-action doctrine is not applicable to private conduct in an appropriate case under the *Midcal* standards.

C. There Is No Conflict Between the Circuits on Application of the State-Action Doctrine to Sherman Act § 2 Claims.

The purported conflict between the circuits, and between the Ninth and Third Circuits and the Supreme Court, that Transphase asserts concerning application of the state-action doctrine in the context of a Sherman Act § 2 claim simply does not exist. Neither the district court's ruling in this case, nor the Third Circuit's decision in *Yeager's Fuel, Inc.* v. *Pennsylvania Power & Light Co.*, 22 F.3d 1260 (3d Cir. 1994), contradict the self-evident principle that regulated utilities do not have a *blanket* immunity from the antitrust laws. *See Cantor* v. *Detroit Edison Co.*, 428 U.S. 579 (1976); *Otter Tail Power Co.* v. *United States*, 410 U.S. 366 (1973); *Town of Concord* v. *Boston Edison Co.*, 915 F.2d 17, 21 (1st Cir. 1990), *cert denied*, 499 U.S. 931 (1991). Rather, the district court here, and the Third Circuit in *Yeager's Fuel*, found that the specific activities at issue in the cases before them were conducted pursuant to a clearly articulated state policy and were actively supervised by the state. This is a straightforward application of well-settled legal principles.

None of the cases cited by Transphase is to the contrary. In *Town of Concord*, *supra*, the First Circuit held that the activities complained of by the plaintiffs did not amount to a violation of Sherman Act § 2. Having found no violation of the Sherman Act, the court obviously had no occasion to determine whether the utility was protected from liability by the state-action doctrine. In *City of Kirkwood* v. *Union Electric Co.*, 671 F.2d 1173 (8th Cir. 1982), the Eighth Circuit did analyze the activities of the defendant corporation under the state-action doctrine, but found that the state's involvement in the activities complained of was not sufficient to satisfy either prong of the *Midcal* test. *City of Kirkwood*, 671 F.2d at 1180.

In addition, *Town of Concord*, *City of Kirkwood*, and the two early Seventh Circuit cases cited by Transphase,[4/] all involved an alleged "price squeeze" by a utility related to the prices it charged for electricity at the wholesale and retail levels. In all of those cases, only the retail rates were controlled by the state, while the wholesale rates fell under the jurisdiction of the Federal Energy Regulatory Commission. The gravamen of a "price squeeze" case is that a defendant, who operates at two levels of an industry, sets its wholesale price too high and its retail price too low, such that a competitor who operates on only one level of the industry cannot cover its costs and stay in business. It is therefore the relationship between the two prices, not the level at which each price is independently set, that forms the basis of a plaintiff's antitrust claim. Where, as in the cases cited by Transphase, only one of the prices is under the control of the state, the courts found no basis for finding that the *relationship* between the two prices was protected under the state-action doctrine. As was stated by the Seventh Circuit in *Mishawaka I*, the states "in no way placed a badge of approval on the defendant's *dual rate structure*." *Mishawaka I*, 560 F.2d at 1320 (emphasis added).

As a final point, the question of the existence of any current conflict between the Seventh and Ninth Circuits is put to rest by more recent Seventh Circuit cases, such as *Fuchs* v. *Rural Electric Convenience Coop, Inc.*, 858 F.2d 1210 (7th Cir. 1988), *cert. denied*, 490 U.S. 1020 (1989), in which the court of appeals did apply the state-action doctrine to claims of horizontal market allocation *and* monopolization against a private, investor-owned regulated public utility. *See also Ball Memorial Hospital, Inc.* v. *Mutual Hospital Ins., Inc.*, 784 F.2d 1325 (7th Cir. 1986) (indicating that state-action immunity would apply, given the appropriate factual predicate, to protect nonprofit providers of health care financing accused of violations of Sherman Act §§ 1 and 2).

[4/] *City of Mishawaka, Indiana* v. *American Electric Power Co.*, 616 F.2d 976 (7th Cir. 1980), *cert. denied*, 449 U.S. 1096 (1981) (*Mishawaka II*); *City of Mishawaka, Indiana* v. *Indiana & Michigan Electric Co.*, 560 F.2d 1314 (7th Cir. 1977), *cert. denied*, 436 U.S. 922 (1978) (*Mishawaka I*).

II. THE COURTS BELOW CORRECTLY DETERMINED THAT CALIFORNIA HAS A CLEARLY ARTICULATED STATE POLICY TO DISPLACE COMPETITION.

The district court held that the California legislature has a "clearly articulated and affirmatively expressed" policy to displace competition with respect to DSM bidding and the ratemaking process. This ruling, which was upheld by the court of appeals, was the result of a straightforward application of the well-settled precedent of this Court. *See* Pet. App. 7a, citing *Southern Motor Carriers Rate Conf.* v. *United States*, 471 U.S. 48 (1985); *City of Lafayette* v. *Louisiana Power & Light Co.*, 435 U.S. 389 (1978). Transphase's petition raises no conflict among the circuits as to the standard applied in this case. Transphase argues simply that the district court erred in applying the accepted legal standard to the specific circumstances of California's regulation of DSM activities.

Transphase's argument thus relates only to the application of the clear principles of the *Midcal* test to a specific program under the California regulatory regime. For that reason alone Transphase's argument does not raise an appropriate issue for issuance of a writ. Beyond that, the district court was correct in ruling that the statutory framework passed by the California legislature to govern the regulation of DSM bidding and ratemaking evinced a clear policy to displace competition. Section 747 of the California Public Utilities Code, cited by the district court in its decision, sets out in detail the manner in which the CPUC should regulate the bidding for DSM resources, directing the CPUC to implement "pilot programs" to test the feasibility of combined DSM and SSM bidding, and to report the results of these pilot programs to the legislature. The California Public Utilities Code sets out the criteria by which rebates for DSM are to be determined, and also prohibits the CPUC from changing any rate, or changing the classification, contract practice or rule as a result of the new rate, except upon a showing that the new rate is justified. *See* CPUC §§ 454(a), 701.1(c).

The statutes that Transphase cites in its petition do not, as Transphase asserts, amount to a "clarion call" mandating

complete deregulation of the DSM market. Rather, they are directives to the CPUC instructing it on the manner in which the market for DSM should be regulated. For example, Chapter 984, 1983 Cal. Stat, cited by Transphase, instructs the CPUC "*to regulate* the involvement of electrical and gas corporations in energy conservation development" to ensure that utilities do not dominate the energy conservation business. *Id.* (emphasis added). At most, this provision calls for a particular regulatory focus -- not deregulation.

The first prong of the *Midcal* test is satisfied where the legislature has instructed that a specific field of activity be subject to regulation, with the foreseeable consequence that competition will be suppressed. *City of Columbia*, 499 U.S. at 372-73; *Town of Hallie* v. *City of Eau Claire*, 471 U.S. 34, 42 (1985). Given the pervasive state regulation of the specific activities of which Transphase complains, and the state's clear intention to displace unfettered competition with a program of supervised control, the district court was correct in ruling that both prongs of the *Midcal* test had been satisfied.

III. THE DISTRICT COURT CORRECTLY DECLINED PETITIONER'S REQUEST TO CONVERT RESPONDENTS' MOTIONS TO DISMISS INTO MOTIONS FOR SUMMARY JUDGMENT.

In the course of finding that the "active supervision" prong of the *Midcal* test was satisfied, the district court took judicial notice of the administrative decisions of the CPUC as demonstrating the extensive regulation of the DSM bidding and ratemaking process. Transphase argues in its petition that the district court's failure to convert the utilities' motions to dismiss into motions for summary judgment was a violation of Federal Rule of Civil Procedure 12(b) and Federal Rule of Evidence 201(b). The district court's ruling on this issue, contained in footnote 5 of its decision, was not addressed in the court of appeals' unpublished affirmance.

Transphase's argument on this issue is by its very nature completely fact-bound. In addition, the district court's use of the CPUC decisions to conclude that the state had exercised

active supervision over DSM bidding and rebates was a straightforward application of both Federal Rule of Evidence 201(b) and Ninth Circuit law. *See Nugget Hydroelectric, L.P.* v. *Pacific Gas & Electric Co.*, 981 F.2d 429, 435 (9th Cir. 1992), *cert. denied*, 113 S.Ct. 2336 (1993) (taking judicial notice of CPUC decisions to establish "active supervision" prong of *Midcal*). *See also Brennan* v. *Chestnut*, 973 F.2d 644, 647 (8th Cir. 1992) (taking judicial notice of decision of NLRB administrative law judge); *United States* v. *Camp*, 723 F.2d 741, 744 n.** (9th Cir. 1984) (taking judicial notice of order from California Attorney General).

Transphase cites no case law of this Court or any other that is contrary to the district court's ruling in this case or the Ninth Circuit's ruling in *Nugget Hydroelectric*, *supra*. Transphase's attempt to assert a conflict between the Ninth and Third Circuits, based upon the *Yeager's Fuel* court's conversion of defendant's 12(b)(6) motion to dismiss to a motion for summary judgment because the defendant attached "various [unidentified] documents" to its motion,[5] falls considerably short of the mark. In short, Transphase presents no compelling reason for this Court to grant a writ on this fact-bound evidentiary ruling by the district court.

IV. THE DISTRICT COURT'S DECISION RESTED UPON TWO ALTERNATIVE GROUNDS WHICH WERE SUFFICIENT TO SUPPORT THE JUDGMENT.

In addition to dismissing Transphase's complaint on the basis of the state-action doctrine, the district court also found that Transphase's claims under the Sherman Act were barred under two alternative grounds. First, the court held that the actions taken by the utilities that formed the basis of Transphase's complaint were protected under the *Noerr/Pennington* doctrine. Specifically, the district court held that both Transphase's allegations under Sherman Act § 1, that the utilities had appeared together before the CPUC and "acted

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[5] *Yeager's Fuel*, 22 F.3d at 1272.

in unison" before that body, and its allegations under Sherman Act § 2, that the utilities had "resisted meaningful changes" in DSM regulation through their positions before the CPUC, fell squarely under the protection provided by *Noerr/Pennington* against liability for petitioning the government. (Pet. App. 12a-13a)

The district court also found that Transphase's antitrust claims were defective because Transphase had failed to allege a relevant market in which both Transphase and the utilities were competitors. Transphase characterized the relevant market as "DSM resources," with an apparent submarket of "retrofit thermal energy storage (TES) goods and services." (Pet. App. 14a) However, as the district court noted, Transphase also stated in its complaint that the utilities "are not themselves capable of supplying [these] goods and services. . . ." (Pet. App. 15a) Given Transphase's admission that the utilities had no substantial presence in the relevant market, the court held that as a matter of law the utilities could not be found liable for monopolization, attempted monopolization, or conspiracy to monopolize that market. (Pet. App. 16a) *See Spectrum Sports, Inc.* v. *McQuillan*, 113 S. Ct. 884 (1993).[6/]

This Court "reviews judgments, not statements in opinions." *Black* v. *Cutter Laboratories*, 351 U.S. 292, 297 (1956). Thus, these alternative grounds for the district court's judgment eliminate any conceivable need for granting of the writ.

[6/] Respondent SDG&E raised in the lower courts yet an additional ground for dismissal of the complaint: Transphase's failure to allege any anticompetitive conduct by respondents and/or antitrust injury to itself. The central claim in Transphase's complaint was that the utilities failed to pay sufficient subsidies to make DSM products viable to customers. While the payment of insufficient subsidies might conceivably be a breach of the utilities' obligations under a state regulatory program, it does not state a claim of anticompetitive conduct under the Sherman Act.

CONCLUSION

Respondent SDG&E respectfully requests that the petition for a writ of certiorari be denied.

Respectfully submitted,

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September 30, 1994

No. 94-394

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1994

TRANSPHASE SYSTEMS, INC.
Petitioner,
VS.
SOUTHERN CALIFORNIA EDISON COMPANY AND
SAN DIEGO GAS & ELECTRIC COMPANY
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF FOR RESPONDENT SOUTHERN CALIFORNIA EDISON COMPANY IN OPPOSITION

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QUESTIONS PRESENTED

1. Does the "state action" doctrine as enunciated in *Parker v. Brown*, 317 U.S. 341 (1943), and its progeny apply to private conduct alleged to be in violation of Section 2 of the Sherman Act?

2. Did the District Court err in finding that California had clearly articulated and affirmatively expressed a policy to displace competition between supply-side and demand-side energy alternatives with respect to the controlled solicitation of bids for new electric generating capacity, and the use of ratepayer funds to subsidize demand-side management ("DSM") programs?

3. In determining whether the state had actively supervised the alleged anticompetitive conduct, did the District Court err in (a) taking judicial notice of official decisions of the California Public Utilities Commission and (b) not converting a Federal Rule of Civil Procedure 12(b)(6) motion into a Federal Rule of Civil Procedure 56 motion after taking judicial notice of matters in the public record?

PARTIES TO THE PROCEEDINGS

The parent company of Southern California Edison Company is SCEcorp. Except for wholly-owned subsidiaries, there are no subsidiaries of Southern California Edison Company.

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No. 94-394

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1994

TRANSPHASE, INC.
Petitioner,
VS.
SOUTHERN CALIFORNIA EDISON COMPANY and
San Diego Gas & Electric Company
Respondents.

Petition for Writ of Certiorari
to the United States Court of Appeals
for the Ninth Circuit

BRIEF FOR RESPONDENT SOUTHERN CALIFORNIA EDISON COMPANY IN OPPOSITION

Respondent SCE respectfully submits that the Petition should be denied because the District Court and Court of Appeals were correct and because there are no special or important reasons to grant certiorari.

STATEMENT OF THE CASE

After years of participating in regulatory proceedings before the California Public Utilities Commission ("CPUC"), petitioner, Transphase Systems, Inc.

("Transphase") filed a private antitrust action against Southern California Edison ("SCE") and San Diego Gas & Electric Company ("SDG&E") in the United States District Court for the Central District of California. The Complaint alleged claims for monopolization, attempted monopolization and conspiracy to monopolize in violation of Section 2 of the Sherman Act, and a conspiracy to restrain trade in violation of Section 1 of the Sherman Act, as well as various pendent state law claims.[1] SCE and SDG&E filed motions to dismiss Transphase's Complaint pursuant to Federal Rule of Civil Procedure 12(b)(6), arguing, among other things, that the specific alleged anticompetitive acts (*e.g.*, excluding demand side management ("DSM") alternatives from the solicitation of bids for new electric generating capacity and establishing "rebate" levels for ratepayer-funded DSM subsidies) were immunized under the state action doctrine. SCE relied on an extensive body of reported CPUC decisions, of which the District Court took judicial notice.[2]

The District Court, by Order of the Honorable David V. Kenyon, granted Defendants' Motion to Dismiss. (Pet. App. 3a-17a) In an opinion fully consistent with this Court's precedents, Judge Kenyon found (1) that California had clearly articulated and affirmatively expressed a policy to displace competition with respect to DSM bidding, and the rate making process through which DSM subsidy rebates

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[1]Although Transphase petitions this Court to review the dismissal of its Complaint, a copy of the Complaint is not reproduced in the Petitioner's Appendix. Given the importance of understanding the precise conduct alleged to be anticompetitive, Respondent SCE submits a complete copy of the Transphase Complaint in Respondent SCE's Appendix ("Respondent's Appendix" or "Res. App."). To avoid confusion, the Respondent's Appendix is indexed with "b" numbers.

[2]Copies of the relevant portions of the CPUC decisions are reproduced and submitted in Respondent's Appendix.

were administered, and (2) that the CPUC has actively supervised Defendants' relevant DSM activities, thereby immunizing Defendants' conduct from federal antitrust attack under the state action doctrine.[3] (Pet. App. 7a-11a) Judge Kenyon also explicitly denied Transphase's motion seeking leave to submit evidence on the second prong of the *Midcal* state action test, consisting of a Declaration by Transphase President Douglas A. Ames, and numerous proposed exhibits. Since the District Court held that its consideration of the CPUC decisions did not transform the proceeding into a motion for summary judgment under Rule 56, Judge Kenyon denied Transphase's request to submit evidence on the issue of active state supervision. (Pet. App. 8a n.5)

Transphase filed a timely appeal to the United States Court of Appeals for the Ninth Circuit, seeking review only of its section 2 monopolization and attempted monopolization claims. Reviewing the sufficiency of the Complaint *de novo*, the Court of Appeals, in an unpublished memorandum disposition, affirmed the dismissal "for the reasons given by Judge Kenyon in his order of October 7, 1993 discussing the 'state action' doctrine enunciated in *Parker v. Brown*, 317 U.S. 341 (1943) and its progeny." (Pet. App. 2a) The present petition seeks review of that ruling.

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[3]The District Court also found that the specific acts alleged to be unlawful (appearing before the CPUC, filing joint briefs, speaking in unison, and actively resisting changes in rebate programs) constituted petitioning activities protected under the *Noerr-Pennington* doctrine. *See United Mine Workers v. Pennington*, 381 U.S. 657 (1965); *Eastern R.R. Presidents Conf. v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961). (Pet. App. 12a-13a) Finally, the court found that SCE and SDG&E did not compete in Transphase's alleged market. (Pet. App. 13a-16a) Defendants also argued that the Complaint failed to allege an antitrust injury. The District Court noted this argument, but found it unnecessary to decide the issue in light of the other deficiencies in the Complaint. (Pet. App. 4a n.1)

STATEMENT OF THE FACTS

Respondent SCE has an obligation to fully appraise the Court of facts relevant to the issues before it. *See* Supreme Court Rule 15.1. To determine whether actions are immune under the "state action" doctrine, it is necessary to understand the nature of the specific conduct alleged to be anticompetitive and to examine that conduct in light of the applicable state regulatory structure. Unfortunately, Transphase's Petition never discusses the specific acts that its Complaint alleged to be anticompetitive and, although central to an examination of the state action issue, the Petition is devoid of any discussion of the years of CPUC proceedings regarding DSM-related matters in which Transphase was an active participant. It falls upon SCE to describe the allegations in the Complaint and to summarize the CPUC proceedings that are necessary to this Court's assessment of the issues raised in Transphase's Petition.

A. Summary of the Complaint's Allegations

Transphase is a seller of "Thermal Energy Storage" ("TES") systems, a subset of DSM technology designed to facilitate energy savings by shifting demand from peak to off-peak periods. Compl. ¶¶ 4, 8-11 (Res. App. 83b, 85b-86b). Buyers of such TES devices typically are large electricity users interested in purchasing various forms of energy conservation services. As conceded in the Complaint, Transphase's real problem is that its product is inherently "uneconomic." "[I]t is usually considered uneconomic for a host to pay for the entirety of a Transphase system; the payback period, *i.e.*, the number of years until the host recoups the cost of the system, may be too long." Compl. ¶ 14 (Res. App. 87b). Apparently, either Transphase's costs are too high or the savings generated by its TES technology are too small for Transphase's products to be independently attractive. As a consequence, Transphase must rely upon

subsidies in the form of "rebates" paid to utility customers. *Id.* These rebates are paid exclusively out of ratepayer funds. Compl. ¶ 15 (Res. App. 88b).

SCE and SDG&E are regulated electric utilities, distributing and selling electricity to customers in different parts of Southern California. Compl. ¶¶ 5-6 (Res. App. 84b). Transphase acknowledges that these activities enjoy "state action" immunity pursuant to *Parker v. Brown*. Compl. ¶ 32 (Res. App. 95b). Transphase's Petition seeks review only of the dismissal of its Sherman Act Section 2 monopolization and attempted monopolization claims. The Petition, however, contains little or no discussion regarding exactly what SCE is supposed to have done in violation of Section 2.[4] For guidance, it is necessary to look at paragraphs 19-26 of the Complaint (Res. App. 89b-93b) , which make the following Section 2 allegations:

- SCE excludes Transphase and other DSM providers when it solicits bids for supply-side generating capacity;
- SCE suppresses the aggregate level of ratepayer funds authorized for DSM subsidy programs;
- SCE controls DSM rebate subsidy levels and the calculation of "avoided costs" which allegedly limits permissible subsidy rebate levels; and

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[4]Instead, the Petition offers vague, conclusory assertions like SCE somehow uses its "power to destroy the energy efficiency services and equipment markets." Pet. at 6-7. But, no market is defined and no participants are identified. It is even unclear what the product is or who are the buyers or sellers. What SCE's "power" is and how it is exercised is never stated. The Petition also claims that SCE and SDG&E "control the price paid to Transphase for electric capacity and energy savings it provides," *id.*, but Transphase is free to sell its TES device to anyone at any price it chooses.

- SCE controls the method of "measurement and valuation ("M&V") used to calculate energy savings from DSM devices.

See also Pet. App. 6a, 10a-11a (District Court summarizing Section 2 allegations). The Complaint does not allege restrictions of any sort on Transphase's ability to contact prospective buyers, solicit business or enter into sales agreements. Thus, Transphase is free to sell as many TES systems as it can find willing buyers.

B. The History of the CPUC's Regulation of DSM Subsidy Programs and the Relationship Between Demand-Side and Supply-Side Energy Alternatives

The District Court properly took judicial notice of numerous CPUC decisions directly relevant to the alleged anticompetitive conduct. (Pet. App. 8a n.5) While SCE regrets the length of the description necessary to provide the Court with even a summary of the CPUC's relevant DSM proceedings, the Court's indulgence is requested because an understanding of the CPUC decisions is essential to evaluating the state action issue; determining the degree of state supervision; and assessing the propriety of exercising judicial notice. The CPUC proceedings concern two distinct but related sets of issues. The first involves the authorization and supervision of DSM subsidy programs employing ratepayer funds. The second involves the CPUC's exclusion of DSM resources from the solicitation of bids for new generating capacity and the development of a pilot program to test the efficacy of competitive demand-side bidding.

1. CPUC Authorization and Oversight of DSM Rebates In SCE's 1988 and 1992 General Rate Cases

Before SCE can devote *any* ratepayer funds to DSM subsidies, such as those for Transphase's TES systems, SCE must obtain prior CPUC authorization. On December 22,

1987, the CPUC issued its final decision on SCE's 1988 General Rate Case.[5] As part of the 1988 Rate Case, SCE requested the CPUC's permission to devote rebate subsidy funds to TES. This request "was supported . . . by the CEC [California Energy Commission] and *Transphase Systems, Inc.*" *1988 GRC* at 475 (emphasis added) (Res. App. 3b). The permanent CPUC staff, whose job it is to represent the interests of California ratepayers, opposed SCE's request. *Id.* at 475-76 (Res. App. 3b-7b). While the CPUC permitted funding, it expressed reservations concerning the rebate levels *jointly supported by SCE and Transphase.* The Commission was concerned that previous rebate levels of $200/kW were not cost effective.[6] To ensure proper use of ratepayer funds, the Commission ordered "Edison to submit a cost-effectiveness analysis for all TES program incentive payments on a project by project basis." *Id.* at 476 (Res. App. 6b). Additionally, the Commission ordered SCE "to quantify the extent to which all TES expenditures are cost-effective in accordance with the recently revised *Standard Practice For Economic Evaluation Of Demand Management Programs.*" *Id.* at 476 (Res. App. 6b).

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[5]*See In re Southern California Edison Co.*, D. 87-12-066, 26 CPUC 2d 392 (Dec. 22, 1987) ("*1988 GRC*"). Relevant portions of the *1988 GRC* are included in Respondent's Appendix. (Res. App. lb-7b). Each of the CPUC decisions cited in this brief and included in Respondent's Appendix was attached as an exhibit to SCE's Motion to Dismiss and was judicially noticed by the District Court.

[6]SCE's and Transphase's collective difficulty in persuading the CPUC that TES rebates of $200/KW were *cost effective* gives a useful perspective on plaintiff's unsupported speculation that rebate prices of $1000/KW could somehow be justified. *See* Pet. at 9 n.2.

On December 20, 1991, the CPUC issued its final decision in SCE's 1992 GRC.[7] The CPUC continued to actively supervise both the total amount of money available for TES subsidies and the TES rebate subsidy levels paid to commercial electricity customers. The CPUC staff charged with representing the ratepayers again argued that *all* TES funding in the *1992 GRC* should be eliminated, this time because TES projects supposedly failed to establish their efficacy under the Total Resource Cost test ("TRC"). Alternatively, the CPUC staff sought a rebate cap of $50 per kilowatt. *See 1992 GRC* at 169 (Res. App. 11b). SCE opposed these limitations and ultimately, the CPUC authorized the TES funding requested by SCE, and refused to adopt the $50 per kilowatt rebate cap advocated by ratepayer counsel.[8] *Id.*

2. The CPUC Establishes "Interim Rules" Governing DSM Programs and Outlines a "Pilot Program" to Test the Feasibility of Competitively Bidding DSM Resources

On February 20, 1992, pursuant to a directive of the California Legislature, *see* California Public Utilities Code Section 747, the CPUC announced general rules governing DSM resources and outlined a pilot program for instituting competitive bidding for the provision of DSM services."[9] Transphase filed comments and was actively involved in this

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[7] *See In re Southern California Edison Co.*, D. 91-12-076, 130 PUR 4th 97 (Dec. 22, 1991) ("*1992 GRC*"), relevant portions of which can be found in Respondent SCE's Appendix. (Res. App. 8b-12b).

[8] Transphase's attempt to create an impression that SCE has suppressed DSM rebates and keeps them artificially low (Pet. at 23) is, therefore, demonstrably false.

[9] *See In re Rules and Procedures Governing Utility Demand-Side Management*, D. 92-02-075, 131 PUR 4th 139 (Feb. 20, 1992) ("*Interim DSM Rules*"). A copy of the relevant portions of this decision is submitted in Respondent's Appendix. (Res. App. 13b-38b)

proceeding. *See Interim DSM Rules* at 143 (Res. App. 16b). In the *Interim DSM Rules*, the CPUC articulated principles and policies that clearly establish, contrary to Transphase's repeated allegations (*see* Compl. ¶¶ 20, 22, 24, 26-27 (Res. App. 89b-94b)), that *the CPUC* — not the utilities — will decide if, when, and how DSM resources and supply-side alternatives will be bid competitively. *See Interim DSM Rules* at 143-46 (Res. App. 14b-23b). The CPUC reiterated that it was " 'committed to head-to-head comparison of DSM and supply options in the planning process, and perhaps ultimately in the bidding process as well.' " *Id.* at 145 (Res. App. 19b). *Interim DSM Rules* set out a pilot bidding process in which DSM resources and supply-side bidding proceed separately, with close CPUC monitoring to develop the database necessary for direct DSM versus supply-side bidding, if such a head-to-head comparison proves feasible. *See Id.* at 145-46 (Res. App. 18b-23b).

Moreover, in *Interim DSM Rules*, the CPUC established the general formula through which "avoided costs" are to be estimated as a basis for calculating the overall cost effectiveness of DSM programs, such as Transphase's TES systems. *See Interim DSM Rules* at 152-57 (Res. App. 23b-36b). The CPUC considered a number of alternative DSM cost effectiveness methodologies, and narrowed the alternatives to the Total Resource Cost test ("TRC") and the Utility Cost test ("UC"). *See Id.* at 153-54 (Res. App. 25b-30b). UC measures only the net change in a utility's revenue requirements caused by a DSM program, including program costs, rebates to customers and any increased supply costs for the periods in which electricity demand is increased. *Id.* at 153 (Res. App. 25b). The TRC test, in contrast, includes the utility's costs and *the total costs to the purchasers* of the DSM device or program. *Id.* at 154 (Res. App. 27b). The CPUC ultimately rejected the UC measure in favor of the

TRC test, in part, because *the UC test, as advocated by Transphase would have improperly biased the calculation of DSM savings* in comparison with the costs of supplying new power. *Id.*[10]

3. The CPUC Rejects Transphase's Effort to Force Immediate Demand Versus Supply-Side Bidding in the "Biennial Resource Plan Update"

In its Biennial Resource Plans, the CPUC makes ongoing assessments of the state's future energy requirements and authorizes the utilities to solicit bids for the provision of additional generating capacity to meet the state's anticipated energy needs. The CPUC issued the Biennial Resource Plan Update ("BRPU") on April 22, 1992.[11] Transphase attempted to intervene in the BRPU based on its view, now the basis for most of its substantive antitrust allegations (*see* Compl. ¶¶ 20, 22, 24-27 (Res. App. 89b-94b)), that TES vendors must be permitted to compete directly against new generating facilities for ratepayer funds allocated by the CPUC. Transphase tried to force the CPUC to consolidate the BRPU with the DSM pilot bidding program announced in *Interim DSM Rules. BRPU* at 227 (Res. App. 54b). Obeying its legislative mandate and applying its unique expertise, the CPUC rejected Transphase's efforts to force the combination of DSM bidding with supply side power generation because it preferred "to test various forms of DSM bidding on a pilot scale, before allocating a large

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[10]Transphase persists in applying this discredited methodology by failing to explicitly incorporate the cost of the DSM device and its installation when making comparisons between DSM resources and supply-side alternatives. *See, e.g.*, Pet. at 9 n.2.

[11]*See In re Biennial Resource Plan Update*, D. 92-04-045, 132 PUR 4th 206 (April 22, 1992) ("*BRPU*"). The relevant portions of the decision discussing Transphase's requests are submitted in Respondent's Appendix. (Res. App. 53b-56b)

amount of capacity through any single auction and form of bidding." *Id.* (Res. App. 55b)

Transphase's motion to reconsider the decision barring direct DSM/supply-side competition was denied, and resulted in a separate CPUC Decision.[12] Transphase is essentially using the present antitrust proceedings as a proxy to overturn this CPUC Decision.[13] In its Order, the CPUC repeated its refusal to allocate "a large amount of capacity through any single auction and form of bidding" prior to completion of the pilot DSM program. *Order*, D. 92-07-027, at 2 (Res. App. 58b). The CPUC pointed out that Transphase was now a party in the "Demand-Side Management ("DSM") Rule-Making/Investigation ("OIR/OII")" where an integrated bidding pilot *could* "be accommodated" in the future, if appropriate. *Id.* The CPUC also observed that it was "making every effort to test integrated bidding pilot(s)" and had already ordered an advisory group

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[12]*See Order Denying Rehearing on Decision 92-04-045*, D. 92-07-027 (July 1, 1992). Relevant portions of the CPUC decision are submitted in Respondent's Appendix. (Res. App. 57b-60b) The California Supreme Court refused to hear Transphase's appeal. *See* Order of the California Supreme Court Denying Application for Stay and Petition for Writ of Review, *Transphase Systems, Inc. v. CPUC*, No. S027841 (Cal. Aug. 27, 1992).

[13]In the case at bar, Transphase filed a Motion for Preliminary Injunction seeking to enjoin Defendants' requests for bids to provide billions of dollars worth of new generating capacity, an integral step in the utilities' implementation of the BRPU. Similarly, Transphase's Complaint seeks to enjoin the defendants "from accepting or awarding bids from any independent power producer ... unless and until Transphase and other DSM providers are allowed to compete in the solicitation." (Res. App. 101b) Alarmed over the prospects that the injunction would derail complex state regulatory proceedings designed to meet California's future energy needs, the CPUC filed an *amicus brief* in opposition to Transphase's motion for preliminary injunction. *See* District Court Record, CR-35 at 8. The motion for preliminary injunction was mooted when the Complaint was dismissed.

of utilities, DSM industry members, environmentalists and CPUC staff "to develop an options paper on the subject, due on or before January 1, 1993." *Id.* at 3 (Res. App. 59b).

4. The CPUC Issues Detailed Rules Governing DSM Bidding Pilots and Rejects Arguments by Transphase that SCE and SDG&E Manipulated DSM Rebates and Avoided Costs

On September 16, 1992 the CPUC issued a pivotal decision in the DSM rule making proceedings (where Transphase was a party). The decision detailed the specific structure of the DSM bidding pilot programs which had been described conceptually in *Interim DSM Rules* and considered and rejected many of charges Transphase raises in its federal antitrust Complaint.[14] First, Transphase complained about the anticompetitive impact of alleged DSM rebate manipulation. *Compare* Pet. at 8, 29 n.8 (discussing Ames Declaration). The CPUC found Transphase's evidentiary showing inadequate, and rejected the assertion that utility manipulation had occurred simply because DSM rebates were not as high as Transphase would like. *See In re DSM Procedures* at 386 (Res. App. 42b-43b). As for the utilities' alleged manipulation of "avoided costs" (*compare* Pet. 8-9, 29 n.8), the CPUC found Transphase's "reliance on per kW [kilowatt] cost comparisons as evidence of utility inefficiencies" to be "*misleading*". *Id.* at 387 (Res. App. 43b) (emphasis added). Transphase's assertions of "commensurate energy savings, at lower total costs" if third parties like Transphase were allowed to bid directly against the projected cost for increasing capacity, "presumes an outcome of DSM bidding that we have yet to test." *Id.* The

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[14] *See In re Rules and Procedures Governing Utility Demand-Side Management*, D. 92-09-080, 136 PUR 4th 369 (Sept. 16, 1992) ("*In re DSM Procedures*"). Relevant portions of the decision are submitted in Respondent's Appendix. (Res. App. 39b-52b)

CPUC's skepticism resulted from Transphase's failure to present any evidence "that third parties have actually bid at lower total costs to perform similar programs in other parts of the country, or have agreed to subcontract with utilities at lower total costs." *Id.* Based on the very evidentiary record Transphase had created, the CPUC refused to "conclude, as Transphase does, that utilities are using their access to DSM program funds in an anticompetitive manner." *Id.*

Next, the Commission rejected Transphase's argument, now the basis of its antitrust Complaint (Compl. ¶ ¶ 20-22, 24, 26-27, 30-31, 42 (Res. App. 89b-95b, 99b)) that the federal antitrust laws somehow mandate a direct comparison between the cost of DSM technology and the cost of new electric generating capacity. Transphase contended that the CPUC's failure to combine the DSM bidding pilot program with bidding for supply-side resource allocation violated the Sherman Act. The CPUC rejected this contention, noting that "*we are acting under direct legislative mandate to implement DSM bidding experiments and that, by definition, these experiments should be small in scale.*" *In re DSM Procedures* at 388 (Res. App. 46b) (emphasis added). "The state-action doctrine clearly applies to our decision to limit the size and scope of these bidding pilots and to utility actions to carry out pilots which, by definition, limit the access of third parties to ratepayer-funded DSM." *Id.* (Res. App. 45b-46b)

At the same time, however, the CPUC unequivocally stated its willingness and capacity to supervise utility DSM activities to ensure competitiveness. Since DSM expenditures, including rebates, were already closely supervised in General Rate Cases like the 1988 and 1992 SCE rate cycles described above, the CPUC observed that "[t]he potential impact of planned utility DSM activities on competition can most effectively be evaluated in our general rate case proceedings, where we consider DSM funding requests. . . *This*

will provide intervenors, such as Transphase, with a specific forum for bringing potential anticompetitive program design problems to our attention. In re DSM Procedures at 389 (Res. App. 47b-48b) (emphasis added).

5. The CPUC Closely Supervises the Pilot DSM Program and Directly Monitors SCE and SDG&E DSM Involvement

The CPUC requires SCE and SDG&E to submit periodic filings to the Commission demonstrating that the utilities are in compliance with Commission rules governing DSM programs. On February 17, 1993 (less than three months before Transphase filed the present action in District Court), the CPUC issued an extensive interim opinion evaluating SCE's and SDG&E's compliance with *Interim DSM Rules* and *In re DSM Procedures.*[15] The decision demonstrates the CPUC's continued close supervision of the very acts Transphase alleges to be anticompetitive, *e.g.*, manipulating the calculations of avoided costs (Compl. ¶ 20 (Res. App. 89b)), using different figures for calculating the TRC of its in-house DSM projects than it used for calculating TRC for vendors like Transphase (Compl. ¶¶ 22, 24 (Res. App. 90b-91b)) and manipulating the techniques of measuring and verifying (M&V) DSM energy savings (Compl. ¶¶ 20, 22 (Res. App. 89b–90-b)).

The CPUC discussed at length the utilities' calculation of "avoided costs" to determine DSM rebate levels. *See Interim DSM Bidding Pilots* at 6-8 (Res. App. 63b-66b). The

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[15]*See Interim Opinion SDG&E and SCE's DSM — Only Bidding Pilots Compliance Filings*, D. 92-02-041 (Feb. 17, 1993) ("*Interim DSM Bidding Pilots*"). Relevant portions of the decision are submitted in Respondent's Appendix. (Res. App. 61b-74b). Transphase participated extensively in every aspect of the proceeding that resulted in the CPUC's Decision. *See Interim DSM Bidding Pilots* at 3, 6-8, 14, 16-17, 22, 29-30 (Res. App. 61b-74b).

CPUC specifically noted Transphase's objections to SCE's proposed "avoided cost" calculations. *Id.* at 6 (Res. App. 63b). In connection with the *1992 GRC*, the CPUC had required SCE to update its most recent GRC assumptions for calculating TRC, including those involved in the calculation of "avoided costs." *Interim DSM Bidding Pilots* at 7 (Res. App. 64b). The CPUC noted that in response to its mandate "SCE recently [on December 18, 1992] updated its GRC forecasts of DSM program savings and earnings projections for 1993" and that "[n]o protests have been filed." *Id.* at 8 (Res. App. 65b). Moreover, in evaluating pilot DSM proposals, including TES projects like Transphase's, the CPUC ordered SCE to "utilize the avoided costs underlying" its most recent projections. *Id.*

The CPUC observed that these actions "ensure that SCE and SDG&E will be valuing the resource benefits of bidders' proposals consistent with the most recent valuation of their own in-house DSM program benefits." *Id.* The CPUC made sure, Plaintiff's contrary allegation notwithstanding (Compl. ¶ 24 (Res. App. 91b)), that SCE would treat its own DSM programs and DSM expenditures involving third parties like Transphase on a completely equal basis when it comes to calculating "avoided cost" and determining program cost effectiveness. *Interim DSM Bidding Pilots* at 8 (Res. App. 65b).

Additionally, *Interim DSM Bidding Pilots* demonstrates that the CPUC is responsive to the claims of DSM vendors. In proceedings conducted before the filing of Transphase's Complaint, the CPUC agreed with Transphase's objections regarding M&V. *See Interim DSM Bidding Pilots* at 22 (Res. App. 70b). *Adopting Transphase's objection*, the CPUC ruled that, for the DSM bidding pilots, "bidders, not the utility, should be responsible for their own M&V activities and should include the cost of those efforts in the bid price." *Id.* The CPUC went on to observe that the utilities'

role should be limited to "augment[ing] the bidders' ex-post M&V plan, as needed, to meet the adopted ex-post measure requirements for earnings recovery or resource planning purposes." *Id.* (Res. App. 70b) *Compare* Compl. ¶ 20 ("the utilities . . . establish . . . the manner, or lack thereof of measuring and verifying ["M&V"] that the electricity savings projected for the DSM measures are actually achieved."). (Res. App. 90b).

6. The CPUC Permits the Integrated Bidding of Demand and Supply-Side Resources on a Pilot Basis

As previously discussed, when the CPUC rejected Transphase's attempt to consolidate the BRPU and the DSM pilot bidding program, it also observed that an "integrated" bidding pilot directly comparing demand and supply-side alternatives *could* be accommodated in the ongoing DSM bidding pilot if appropriate, and ordered preparation by January 1, 1993 of an "options paper" discussing integrated bidding. *See supra* pp. 12-13. Armed with that options paper, the CPUC issued a decision on June 3, 1993, finding that "Public Utilities (PU) Code § 747 requires one or more electric utilities to solicit megawatts under an integrated bidding pilot program, where supply- and demand-side bidders compete to fill a common block of resource needs."[16]

The Commission announced its resolve "to issue a request for proposals for the pilot sometime in 1994 or early 1995." *Integrated Bidding Pilot Programs* at 20-21 (Res. App. 80b). Moreover, the CPUC announced an intention to proceed with an integrated bidding pilot even if electric utilities did not otherwise contemplate "a supply-side solici-

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[16]*See Interim Opinion on Integrated Bidding Pilot Programs: Threshold Issues*, D. 93-06-040 (June 3, 1993) at 2 ("*Integrated Bidding Pilot Programs*"). (Res. App. 75b). Relevant Portions of the decision are submitted in Respondent's Appendix (Res. App. 75b-81b)

tation . . . in 1994 or 1995" by using an integrated bidding pilot to meet preexisting "projections of need for additional demand- and supply-side resources." *Id.* at 21 (Res. App. 81b). In so doing, the CPUC demonstrated its complete (and unilateral) control over the central subject matter of this dispute. The CPUC, pursuant to state statute, will decide whether and when a utility such as SCE can accept competing bids from demand-side and supply-side resource alternatives.

REASONS FOR DENYING THE WRIT

Transphase's Petition raises settled issues of law. The District Court correctly applied the two-prong *Midcal* test governing state action immunity. By challenging the applicability of the state action doctrine to private parties and to section 2 claims generally, Transphase questions issues that this Court has already resolved. All of Petitioner's remaining objections fail to raise important federal questions and concern only the application of settled rules to the facts of this particular case, issues which were properly decided by the District Court.[17]

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[17]Petitioner's "issues" aside, review of the relevant CPUC proceedings demonstrates that the District Court and the Ninth Circuit were properly applying the state action doctrine to prevent use of the Sherman Act to collaterally attack ongoing and completed state administrative proceedings.

I.

THE COURT BELOW CORRECTLY APPLIED THIS COURT'S GOVERNING STANDARDS FOR GRANTING STATE ACTION IMMUNITY

The District Court correctly applied settled law in granting SCE state action immunity.[18] (Pet App. 7a-8a) Closely following the two-prong test announced in *Midcal*, the District Court held and the Court of Appeals affirmed (1) that California has a clearly articulated and affirmatively expressed policy to displace competition with respect to DSM bidding and the expenditure of ratepayer funds, (Pet. App. 9a) and (2) that the CPUC has "actively supervised every aspect of SCE and SDG&E's DSM activities attacked by Transphase's Complaint." (Pet. App. 11a).[19]

The objections raised in Transphase's Petition implicate issues that have already been heard and settled by this Court. First, Transphase suggests that *Parker* applies only to

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[18]The District Court drew directly upon this Court's decisions in *Parker v. Brown*, 317 U.S. 341 (1943); *City of Columbia v. Omni Outdoor Advertising, Inc.*, 499 U.S. 365, 370 (1991); *Southern Motor Carriers Rate Conf., Inc. v. United States*, 471 U.S. 48, 57 (1985); *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 105 (1980); *Patrick v. Burget*, 486 U.S. 94, 101 (1988). (Pet. App. 7a-8a)

[19]Transphase's Petition incorrectly suggests that the District Court held that electric utilities have blanket antitrust immunity. *See* Pet. at 11, 19. This is not true. No one in this litigation has ever put forward such a contention. After a careful analysis, the District Court simply concluded that both prongs of the *Midcal* test were satisfied and, therefore, the specific conduct challenged in the Complaint was immune under the state action doctrine. Similarly, no one in this litigation has challenged the teachings or applicability of the Court's decisions in *Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973), or *Cantor v. Detroit Edison Co.*, 428 U.S. 579 (1976).

the conduct of the state and its subordinates. *See* Pet. at 13. The Court has specifically rejected this contention.[20] *See Southern Motor Carriers*, 471 U.S. at 56 ("Although *Parker* involved an action against a state official, the Court's reasoning extends to suits against private parties. The *Parker* decision was premised on the assumption that Congress, in enacting the Sherman Act, did not intend to compromise the States' ability to regulate their domestic commerce.") *Patrick v. Burget*, 486 U.S. at 99-100 ("*Parker*'s federalism rationale demanded that the state action exception apply in certain suits against private parties."); *Cantor*, 428 U.S. at 603-04 (Burger, C.J., concurring). The grant of state action immunity to private actors is not without appropriate controls. When the actions of a private party are at issue, *Midcal*'s second prong is activated and the Court requires proof of active state supervision.[21]

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[20]The Court in *Parker* defined state action to include both actions by the state and actions taken under the State's direction. "The Sherman Act makes no mention of the state as such, and gives no hint that it was intended to restrain state action or official action directed by the state." 317 U.S. at 351

[21]*Midcal*'s second prong, active state supervision, guarantees that the private conduct "actually furthers state regulatory policies." *Patrick*, 486 U.S. at 101. Consequently, *Parker*'s application to private parties is not inconsistent with the "well established principle that 'a state does not give immunity to those who violate the Sherman Act by authorizing them to violate it, or by declaring that their action is lawful.' 317 U.S. at 351 (citing *Northern Sec. Co. v. United States*, 193 U.S. 197, 332, 344-47 (1904))." *Omni*, 499 U.S. at 379. "*Midcal* confirms that while a State may not confer antitrust immunity on private persons *by fiat*, it may displace competition with active state supervision if the displacement is both intended by the State and implemented in its specific details." *F.T.C. v. Ticor Title Ins. Co.*, ____ U.S. ____, 112 S. Ct. 2169, 2176 (1992) (emphasis added). *See also Southern Motor Carriers*, 471 U.S. at 61 n.23 (*Midcal*'s two prongs eliminates the prospects of a state simply giving immunity to private parties who violate the Sherman Act).

Second, Transphase asserts that state action immunity applies to Section 1 Sherman Act claims but not to Section 2 Sherman Act claims.[22] *See* Pet. at 20. Transphase can cite no authority for its proposition that for the last fifty years, "the Circuit Courts have criss-crossed Supreme Court precedent." *See* Pet. at 14. Transphase's attempt to differentiate between Sections 1 and 2 reflects a basic misunderstanding of the state action doctrine. The doctrine is founded upon the "principles of federalism and state sovereignty." *Omni*, 499 U.S. at 370. These principles apply with equal force to both sections of the Sherman Act. While acknowledging that Congress had the constitutional authority to preempt conflicting state law, the Court in *Parker* held that Congress did not intend such a result. "There is no suggestion of a purpose to restrain state action in the Act's legislative history." 317 U.S. at 351.[23] "In a dual system of government in which, under the Constitution, the states are sovereign, save only as Congress may constitutionally subtract from their authority, an unexpressed purpose to nullify a state's control over its officers and agents is not lightly to be attributed to Congress." *Id.* In *Patrick v. Burget*, the Court unhesitatingly applied state action analysis to conduct found to have been in violation of Sections 1 and 2 of the Sherman Act. 486 U.S. at 97, 98. The Court drew no distinction between the Section 1 and Section 2 claims.

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[22]The implications of petitioner's proffered rule are staggering. Every single privately-owned utility in the country would be subject to multiple (and endless) monopolization claims seeking treble damages. Additionally, *every disgruntled participant in a proceeding before any public utilities commission in the country could file a Sherman Act section 2 claim in federal court in an effort to overturn the decisions of state regulatory authorities.*

[23]*See also Cantor*, 428 U.S. 632-35 (Stewart, J., dissenting) (Sherman Act legislative history indicates an "intent not to intrude upon the authority of the several States to regulate their domestic commerce").

Relying upon a series of cases where the alleged anticompetitive behavior was some form of "price squeeze,"[24] Transphase attempts to argue that there is a conflict among the Circuit Courts. These cases, however, are factually distinct. A price squeeze implicates dual state and federal regulatory regimes, neither one of which has authority to approve and supervise both wholesale and retail rates.[25] The case at bar consists of exclusively state authorized and supervised conduct.

Moreover, the cases cited by Transphase are not inconsistent with the grant of state action immunity when both of *Midcal*'s two prongs are satisfied. "Price squeezes" are not immunized because the entire "price squeeze" can neither be authorized nor supervised by the state. In *City of Kirkwood*, the Eight Circuit applied the *Midcal* test to determine whether state action immunity was available to the alleged wholesale/retail price squeeze.[26] 671 F.2d at 1180. The court held that given the dual federal and state regulatory structure, neither *Midcal* prong was satisfied. "[W]hile [the utility's] individual wholesale and retail rates are 'actively supervised' by the [Federal Energy Regulatory Commission] and PSC [the state commission], *Kirkwood chal-*

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[24]*See Town of Concord, Mass. v. Boston Edison Co.*, 915 F.2d 17 (1st Cir. 1990), *cert. denied*, 499 U.S. 931 (1991); *City of Kirkwood v. Union Elec. Co.*, 671 F.2d 1173 (8th Cir. 1982), *cert. denied*, 495 U.S. 1170 (1983); *City of Mishawaka v. American Elec. Power Co., Inc.*, 616 F.2d 976 (7th Cir. 1980), *cert. denied*, 449 U.S. 1096 (1981) (*Mishawaka II*); *City of Mishawaka v. Indiana & Mich. Elec. Co.*, 560 F.2d 1314 (7th Cir. 1977), *cert denied*, 436 U.S. 922 (1978) (*Mishawaka I*).

[25]Obviously, the federal aspects of the "price squeeze" scenario do not implicate the state action doctrine. Not surprisingly, therefore, the First Circuit in *Town of Concord* does not even discuss the state action doctrine.

[26]*City of Kirkwood* is the only case cited by Transphase discussing the state action doctrine that was decided after this Court's decision in *Midcal*.

lenges the interrelation of those rates, which is under the authority of neither Commission." *Id.* (emphasis added).[27] There is no conflict between the Circuit Courts.

II.

The District Court Correctly Determined that California has Clearly Articulated and Affirmatively Expressed a Policy to Displace Competition With Respect to the Conduct At Issue

After examining the relevant statutes and regulations, the District Court concluded that "the *California legislature* has clearly articulated and affirmatively expressed its desire to displace competition with respect to DSM bidding and the ratemaking process." (Pet. App. 9a) (emphasis added). Transphase does not challenge the appropriate legal standard to be employed under *Midcal*'s first prong, but merely challenges the application of the established principle to the facts of this particular case.

The first prong of *Midcal* requires a clearly articulated and affirmatively expressed policy to displace competition. In *Omni*, this Court explained that "[w]e have rejected the

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[27]The Seventh Circuit's pre-*Midcal* decisions of *Mishawaka I & II*, are also consistent with *Midcal*'s two-prong test. The Seventh Circuit reasoned that no state action immunity was available because of the inherent inability of the state to authorize or supervise the entire scheme. "The challenged activity here is a dual rate structure. The state utility commissions have only put the imprimatur of their sanction on the retail rates charged by the defendant.... [The state commissions have in no way placed a badge of approval on the defendant's dual rate structure. Consequently, defendant's conduct is not immunized under *Parker v. Brown*." *Mishawaka I*, 560 F.2d at 1320. In *Mishawaka II*, the court reiterated that the states had not authorized the "price squeeze." "In the present case, Indiana and Michigan have not in any way attempted to create, approve or mandate a Sherman Act violation...." 616 F.2d at 985.

contention that this requirement [*Midcal*'s first prong] can be met only if the delegating statute explicitly permits the displacement of competition, *see* [*Hallie v. Eau Claire*, 471 U.S. 34, 40 (1985)]. It is enough, we have held, if suppression of competition is the 'foreseeable result' of what the statute authorizes, *id.*, at 42." *Omni*, 499 U.S. at 372-373. Here, the CPUC, pursuant to its statutory authority, restricts the direct competition between demand-side and supply-side energy alternatives, except for a legislatively-mandated pilot program. SCE does not have the power to permit the competitive bidding of demand and supply-side resources. *See BRPU* at 227 (Res. App. 54b). Additionally, the CPUC, pursuant to statute, authorizes and administers a subsidy rebate program for DSM equipment such as Transphase's TES devise.[28] The very nature of these programs evidences an intent to displace competition,[29] and the necessary and foreseeable result of the state's policies is an administratively supervised deviation from pure competition.

To suggest a contrary result, Transphase must engage in a selective reading of California law and studiously avoid any direct discussion of the specific conduct alleged in its own

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[28]SCE cannot spend a dime of ratepayer funds on DSM rebates without CPUC approval, and the CPUC is prohibited from changing "any rate" or altering "any classification, contract, practice, or rule as to result in a new rate, except upon a showing before the Commission and a finding by the Commission that the new rate is justified." Cal. Pub. Util. Code § 454(a).

[29]To the extent that the CPUC is involved in the process of passing out rebate subsidies, *the provision of DSM resources in California does not take place in a free market.* Indeed, as Transphase acknowledges, in a truly free market without state supported subsidies, its TES technology is not sufficiently attractive to be economically viable. Compl. ¶ 14 (Res. App. 87b). The greatest irony about this case is that Transphase is seeking to use the antitrust laws to establish an entitlement to a government subsidy.

Complaint. In citing Chapter 984, Statute 1983, the Petition carefully omits that the statute's legislative command is "*a clear and explicit mandate [to the CPUC] to regulate* the involvement of electrical and gas corporations in energy conservation development."[30] Similarly, California Public Utilities Code Section 744.7(e) directs the CPUC that when "reviewing and supervising programs" authorizing the use of ratepayer funds to subsidize energy efficiency programs, the Commission shall do so in a manner consistent with Chapter 984.[31] While Section 747.7(e) states that "[n]othing in this section shall prevent the commission from utilizing a competitive bidding process for all or any part of the work to be performed under these programs," a "competitive bidding process" as a possible tool for implementing state regulatory policy in administering DSM subsidies is not the equivalent of an intent to establish a functioning competitive marketplace. Underlying this point is the fact that the California legislature has been careful not

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[30]The preamble language of Chapter 984 suggests a general legislative desire to promote competition in the *energy conservation industry*, but the actual legislative command in 984 is a clear directive to the CPUC to extend its regulatory reach:

> It is, therefore, the intent of the Legislature that *the Public Utilities Commission be given a clear and explicit mandate to regulate the involvement of electrical and gas corporations in energy conservation development*, and to ensure that the energy conservation industry develops in a manner which is competitive and free from the potential dominance of regulated electrical and gas corporations. Chap. 984, Stat. 1983 (emphasis added); Pet. at 4.

[31]The law also states that "[t]he Commission's findings concerning general ratepayer support of those programs, and its determination that those programs are consistent with the policies expressed in Chapter 984, shall be determinative of those issues unless found to be arbitrary and capricious." Cal. Pub. Util. Code § 744.7(e); Pet. at 20a. Transphase is essentially trying to use the federal antitrust laws to obtain collateral review of state regulatory proceedings.

to interfere with the CPUC's extensive regulation of DSM resources. In enacting California Public Utility Code Section 701.1(i), the legislature expressly stated that nothing in the law "shall be construed to change or alter any provision of the Commission's decision" that rejected Transphase's contention that DSM resources should be competitively bid against supply-side alternatives.[32]

Transphase's reliance on Chapter 1369(§ 1b), 1990 as codified, in part, in California Public Utilities Code Section 747, *see* Pet. at 21a-22a, further illustrates how petitioner confuses carefully controlled legislative directives to the CPUC with policies advocating free and uninhibited competition. Section 747, *again a mandate to the CPUC*, orders the Commission to develop pilot bidding programs, which the Commission has done.[33] The pilot program is a carefully supervised, administrative experiment to test the viability of competition. The very existence of this inherently exclusionary program — on a "pilot" basis — evidences the absence of a functioning competitive market.[34]

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[32]The law states: "No provision of this section shall be construed to change or alter any provision of commission decision 92-04-045, dated April 22, 1992." Cal. Pub. Util. Code § 701.1(i). In Decision 92-04-045, *In re Biennial Cal. Resource Plan Update*, the CPUC explicitly rejected Transphase's contention that the antitrust laws required DSM resources to be competitively bid against supply-side alternatives in the BRPU. *See* discussion, *supra*, pp. 10-11.

[33]*See Interim Rules, supra; In re DSM Procedures, supra; Interim DSM Bidding Plots, supra;* and *Integrated Bidding Pilot Programs, supra.*

[34]Similarly, California Public Utilities Code Section 701.1(c) *directs the CPUC*, when "calculating the cost effectiveness of energy resources" to consider, "in addition to other ratepayer objectives" like the charging of just and reasonable rates, "a value for any costs and benefits to the environment, including air quality." This provision is yet another example of governmental intervention on the basis of criteria unrelated to

III.

In Finding Active State Supervision, the District Court Correctly Took Judicial Notice of CPUC Decisions and Properly Refused to Convert the Preceding into One for Summary Judgment

The District Court found that the CPUC actively supervised every aspect of SCE and SDG&E's DSM alleged by the complaint to be anticompetitive. (Pet. App. 11a) In its Petition, Transphase neither challenges the legal standard employed by the District Court, nor its conclusion that *Midcal's* second prong was satisfied. Indeed, this case presents an unprecedented level of state supervision and control. Instead, Transphase alleges that the District Court erred in taking judicial notice of, official CPUC proceedings in which Transphase was an active participant, and that taking judicial notice of documents in the public record somehow transformed a Rule 12(b)(6) motion into a motion for summary judgment. Both objections involve inherently fact-bound applications of established rules which fail to raise important legal issues.

A. The District Court Correctly Took Judicial Notice Of Official CPUC Decisions

Time and again, throughout years of CPUC proceedings, Transphase has raised the exact same allegations it now charges in its federal antitrust complaint. These repeated challenges have created a lengthy official record, *see* Statement of the Facts, *supra*, pp. 4-17, which illustrates both the plenary authority of the CPUC over DSM-related activities and an unprecedented level of active state supervision. Now,

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economic efficiency that further illustrates the non-competitive aspects of California energy markets as regulated by the CPUC.

Transphase argues that the District Court erred in taking judicial notice of the very *fact* of these proceedings.[35]

Federal Rule of Evidence 201(b) permits a court to take judicial notice of facts "capable of accurate and ready determination by resort to sources whose accuracy cannot be reasonably questioned." Fed. R. Evid. 201(b). Decisions of the CPUC are official records capable of accurate and ready determination and are the proper subject of judicial notice. In exercising judicial notice, the District Court relied upon controlling Ninth Circuit authority. (Pet. App. 8a n.5 (citing *Nugget Hydroelec., L.P. v. Pacific Gas & Elec. Co.*, 981 F.2d 429, 434-35 (9th Cir. 1992) (federal courts may take judicial notice of CPUC decisions when deciding a Rule 12(b)(6) motion made pursuant to the state action doctrine.) (citing cases), *cert. denied*, ____ U.S. ____, 113 S. Ct. 2336 (1993))). Transphase is unable to cite any cases to suggest that this decision was incorrect.[36]

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[35]Transphase mistakenly asserts that the District Court took judicial notice of the fact of CPUC control, *see* Pet. at 31; it did not. The District Court took judicial notice of the CPUC decisions. The decisions are what they are and both sides were free to argue about the inferences that should be drawn from their contents. The District Court concluded that the decisions clearly demonstrated active supervision by the state. (Pet. App. 11a) Transphase's Petition is unable to cite any provision of the CPUC decisions indicating that this conclusion was in error.

[36]Transphase asserts that the CPUC decisions are not official records but rather "adjudicated facts." *See* Pet. at 30-31. This characterization is incorrect. But even if this case involved the judicial notice of adjudicated facts, the CPUC proceedings meet Transphase's proffered test. Transphase was an active participant in the CPUC proceedings and was able to submit comments and argue its case. *See e.g., In re DSM Procedures* at 386-88 (CPUC responding to and rejecting Transphase's specific objections) (Res. App. 40b-47b) ; *Interim DSM Bidding Pilots* at 3, 6-8, 14, 16-17, 22, 29-30 (detailing Transphase's active participation in the proceeding) (Res. App. 61b-73b).

B. Taking Judicial Notice of Matters in the Public Record does not Convert a Motion to Dismiss into a Motion for Summary Judgement

Transphase claims that the District Court erred in not converting the Rule 12(b)(6) motion into a Rule 56 motion. A motion to dismiss may only be converted to a Rule 56 motion if the court acknowledges "matters outside of the pleading." Fed. R. Civ. P. 12(b). It is settled law in the Ninth Circuit that matters knowable to the court through the proper exercise of judicial notice are not "outside of the pleading." The District Court's decision not to convert the proceeding into one for summary judgment was correct and entirely consistent with Ninth Circuit precedent.[37] Transphase's citation to *Yeager's Fuel v. Pennsylvania Power & Light*, 22 F.3d 1260, 1272 (3d Cir. 1994), is misplaced. In *Yeager Fuel, the Third Circuit relied upon PUC decisions and proceedings in holding that active state supervision had been established.* 22 F.3d at 1271-72. In connection with activities not asserted to be immune under the state action doctrine, the Third Circuit found that the record was confused, in part, because "various [unspecified] documents" were attached to the motion. *Id.* at 1272.

Transphase refuses to credit the function of judicial notice and the resulting import of the CPUC's decisions in this case. In considering a Rule 12(b)(6) motion, the court is not obligated to admit as fact allegations which it may judicially notice as not being true. The District Court held

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[37] *See Mir v. Little Co. of Mary Hosp.*, 844 F.2d 646, 649 (9th Cir. 1988) ("In addition to the complaint, it is proper for the district court to 'take judicial notice of matters of public record outside the pleadings' and consider them for purposes of a motion to dismiss.") (quoting *MGIC Indem. Corp. v. Weisman*, 803 F.2d 500, 504 (9th Cir. 1986)); *Mack v. South Bay Beer Distrib., Inc.*, 798 F.2d 1279, 1282 (9th Cir. 1986) (The decision to take judicial notice "does not convert a Rule 12 (b)(6) motion to one for summary judgment.").

that the "reported decisions of the CPUC and the relevant sections of the California Utilities Code clearly establish that *all* of [the following] allegations are false and unsupportable as a matter of law. In fact, the CPUC, not the defendant utilities, have the sole authority to (1) decide whether DSM vendors should be permitted to bid directly against supply side alternatives; (2) establish the amount of DSM funds to be budgeted for TES systems; and (3) decide the ways in which electricity savings derived from DSM systems are measured and verified." (Pet. App. 11a (emphasis in original) (footnotes omitted)). Contrary to Transphase's assertion, the judge's hands are not tied and the court is not required to turn a blind eye to matters of public record. In light of the properly noticed CPUC decisions, the District Court correctly found the existence of active state supervision and dismissed the Complaint pursuant to Rule 12(b)(6).

IV.

CONCLUSION

For the foregoing reasons, Respondent respectfully requests the Court to deny the instant petition for grant of a writ of certiorari.

DATED October 7, 1994

Respectfully submitted,

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APPENDIX

[*392] *California Public Utilities Commission — 26 CPUC 2d

Re Southern California Edison Company

Decision 87-12-066
Application 86-12-047
I.87-01-017

California Public Utilities Commission
December 22, 1987

DECISION, the first issued under the procedures established in Public Utilities Code § 311, reducing an electric utility's base rates by $48.5 million but increasing its major additions adjustment clause by $73.7 million, with an authorized rate of return on common equity of 12.75%.

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1. REVENUES, § 5 — Particular sources — Conservation adjustment clause.

[CAL.] Revenues received by an electric utility through its conservation/load management adjustment clause (CLMAC) were excluded from its revenue projections in the instant case, where the CLMAC was designed to recover expenses from prior years and was not subject to revision in this case.
p. 410.

2. REVENUES, § 15 — Sales of property — Gains or losses — Averages.

[CAL.] Gains or losses experienced by an electric utility in its sales of property and timber were reflected in its revenue projections based on a five-year historical average.
p. 411.

3. EXPENSES, § 120 — Electric utility — Steam production — Components.

[CAL.] In calculating an electric utility's steam production expenses (those expenses, exclusive of fuel, necessary

for operating and maintaining fossil fuel-fired generating facilities), a trending of seven years of recorded data was used, in conjunction with a seven-year average of overhaul expenses and an assumption of abnormal, nonrecurring turbine repair work needing to be done once every three years.
P. 41.

4. EXPENSES, § 120 — Electric utility — Nuclear power production — Components.

[CAL.] In calculating an electric utility's nuclear power production expenses, average-year figures were used based on adjustments to historical data, with increased federal regulatory fees deferred for attrition filings, one-time chemical cleaning expenses amortized over three years, and 70 days used as a reasonable period for refueling outages.
p. 413.

5. EXPENSES, § 120 — Electric utility — Distribution expense — Components.

[CAL.] In calculating an electric utility's distribution expenses, productivity and operational efficiency improvements were found to reduce the number of direct labor hours attributable to line and meter expense, and to tree-trimming expense, but an increase was authorized with respect to initiation of a three-year underground line inspection program.
p.416.

6. PAYMENT, § 51 — Methods of enforcing payment — Termination of service — Notice requirements — Related expenses.

[CAL.] Because utilities are no longer required to post notices of intent to terminate service on the premises where service is to be disconnected, but instead may comply with

the personal notice requirements by mail or by telephone, an electric utility's customer accounts expense relating to termination notices was reduced.
p.418.

7. EXPENSES, § 118 — Uncollectibles — Third-party tracking.

[CAL.] An electric utility was found to have acted reasonably in participating in a program under which applications for service are first tendered to a third-party agency that tracks and matches payment, uncollectibles, and termination records in an effort to reduce

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[*475] *letter requesting the reallocation of $6.4 million of unspent 1985 and 1986 energy management funds. Edison proposed to refund part of the unspent funds and devote the rest to TES and Load Research. PSD protested the advice letter citing the concerns which it has raised in this proceeding. The advice letter was supported, as in this proceeding, by the CEC and Transphase Systems, Inc., a member of TESMAC.

By Resolution E-3053, we concluded that Edison should be authorized to redirect its funds as proposed, but that "the funding limit [for TES] of $200 per kilowatt such as was required for Pacific Gas and Electric Company in Resolution E-3012" would be imposed. (Resolution E-3053, at p.4.) We also ordered that amounts directed to the TES program which could not be used cost-effectively should be returned to ratepayers. Edison was further directed to undertake the same reporting requirements as had been ordered for SDG&E in D.87-08-046.

In none of these decisions have we determined that any load retention resulting from TES installations is the

equivalent of a utility marketing function. Neither do we believe that D.87-05-071, upon which PSD has apparently relied for its definition of marketing, intended this result any more than that decision can be read to exclude TOU-8 customers from participation in any conservation program. With respect to that exclusion, we reject again PSD's assertion and restate our expectation for utilities to retain reasonable and cost-effective conservation and load management programs for large power customers.

Although we believe that a more specific definition of "marketing," which was not included in D.87-05-071, should be developed in the 3-Rs proceeding, we find that certain conclusions about the relation of load retention to marketing can be drawn in this proceeding. To begin with, D.87-05-071 makes clear our continued commitment to reasonable and cost-effective conservation and load management programs even for large power customers and our desire to mitigate uneconomic bypass. The TES program is a DSM program clearly directed to the goal of improving load management for customers installing TES equipment. The fact that the TES program could result in retaining a customer that might, without TES, have chosen to self-generate would also have the desirable impact of preventing bypass. Nowhere in this record is there testimony demonstrating that Edison seeks funding for TES specifically to increase its sales and revenues. Accordingly, we explicitly recognize at this time that load retention is not "marketing" where it serves to allow the utility to keep existing utility loads on the system. We do, however, recognize that there are circumstances where TES could be considered "marketing."

We therefore find that both the load shifting and load retention aspects of TES can be considered in determining the program's cost-effectiveness and that its load retention attributes can be considered in determining the funding for

TES. We do not believe that Edison's inability to quantify the gas-side impact of this program is sufficient to discredit the cost-effectiveness ratios achieved by the TES program under Edison's analysis at this time. We do direct Edison, however, to continue to endeavor to quantify this impact consistent with the recently revised Standard Practice Manual for Economic Evaluation of Demand Side Management Programs.

We therefore find that TES is a cost-effective program which should be extended to small, medium, and large power customers. We are concerned, however, that if the load retention aspect of TES continues to be emphasized to the degree represented by Edison (50% of TES program funding) that it will increasingly appear that the program is one designed more to increase load than to manage load. For these reasons, while we find that the TES program is currently cost-effective and both its load shifting and load retention attributes should be funded, the expenditures related to this program should be closely tracked in the coming years. This tracking can take place by continuing the reporting requirements required by Resolution E-3053 and by establishing, for accounting and reporting purposes, the categories of Load Shifting (Medium/Small and Large Customer) and Load Retention (Medium/Small and Large Customer) suggested by PSD.

[*476] Although we adopt the position here that *cost-effective TES (load retention and load shifting elements) can be funded by ratepayers, we recognize that programs which retain sales in the large light and power (LL&P) class can result in increased profits to Edison if the retained load is not include in sales projections. This is because under the 3-R's decision (D.87-05-071) utility sales to the LL&P class are no longer subject to ERAM. Hence, if the utility's sales are greater than projected, the utility keeps the additional revenues. We do not intend shareholders to profit from ratepayer-funded programs as a result of incomplete sales

forecasts. We therefore expect Edison to forecast load that is retained due to its demand-side management programs, and to include that load as part of its sales forecasts in Commission proceedings.

With respect to funding levels, we are concerned that previously authorized levels of $200/kW may not be cost effective. Accordingly, we order Edison to submit a cost-effectiveness analysis for all TES program incentive payments on a project by project basis. Moreover, we direct Edison to quantify the extent to which all TES expenditures are cost-effective in accordance with the recently revised *Standard Practice for Economic Evaluation of Demand Management Programs.* For overall program funding, we believe that PSD has provided us with the appropriate direction for this funding level in its testimony. Specifically, PSD has stated that its funding recommendation for the TES program, had it included TOU-8 customers, would have been $3.4 million based on recorded 1986 expenditures. Although Edison has indicated an increase in activity, our previous comments reflect our concern that the emphasis in providing incentives for TES installations not shift to a utility marketing effort. For this reason, we adopt and find reasonable a $4 million budget for TES, a funding level which is consistent with recently recorded expenditures and will allow for reasonable growth in the program.

b. *Water Storage*

[33] The Water Storage Program is another area in which the funding proposals of Edison and PSD significantly differ. Edison requests, and the CEC supports, a budget of $1,641,000 for the Water Storage Program. PSD, on the other hand, recommends that no funds be authorized for this program.

According to PSD, this program would result in energy consumption for water pumping by large agricultural cus-

tomers and water districts to be shifted to off-peak periods. Because PSD's and Edison's cost-effectiveness results for this program were marginal, the PSD believes that the program should not be funded.

It is Edison's position, to which the CEC has concurred, that this program is designed to enhance Edison's ability to help major agricultural customers to shift load and lower their operating costs. By eliminating funding for this program. Edison states that DSM program incentives will be inequitably distributed among Edison's customer groups. According to Edison, using PSD's proposed funding levels, approximately 56% of all incentives will be distributed to the residential sector, 44% to the commercial/industrial sector, and 0% to the agricultural and water supply customer group.

We concur with Edison that this program should be funded to achieve its legitimate program goals. As we have stated repeatedly in this order, we recognize the need for cost-effective and reasonable conservation and load management programs for large power customers as well as for residential and small commercial customers. Clearly, the agricultural customers should not be left out of this equation especially when their need to control energy costs is as great as any customer class. We therefore adopt and find reasonable Edison's requested funding level of $1,641,000 for the Water Storage Program. Because we had no other record on reasonable funds for this program, however, we ask Edison to undertake whatever reasonable cost-cutting measures are possible to limit any unnecessary and non-cost-effective spending.

4. *Residential and Non-residential Marketing*

Despite an original funding request for residential and non-residential marketing programs totaling $8.3 million, Edison accepted PSD's

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Re Southern California Edison Company

Decision 91-12-076
Application 90-12-018
I.89-12-025 and I.91-02-079

California Public Utilities Commission
December 20, 1991

INTERIM opinion authorizing base rate revenue requirements for an electric utility in Phase I of a general rate case. The commission approves an authorized level of base rate revenues of $4.012 billion, or an increase of 1.3% over current revenues. The approved increase will result in an increase to overall rates of 0.7%. The commission also adopts marginal costs for the utility for use in Phase 2 of the proceeding to consider revenue allocation and rate design issues. In addition, the utility is directed to share with ratepayers any savings experienced under a cost containment program, as well as institute a shared savings incentive program for demand-side management activities. The commission finds that the utility had failed to meet established standards for the provision information regarding affiliated qualifying cogeneration facilities (QFs), but declines to impose a rate of return penalty. It rules, however, that in future cases on the utility's energy adjustment clause, it might allow recovery of only the lowest available replacement power costs if the utility should continue to offer incomplete information on its QF affiliates.

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1. REVENUES, § 2

[CAL.] Estimates for the future — Effect of bypass by customers — Conservation — Electric utility.
p. 104.

2. EXPENSES, § 95

[CAL.] Salaries and wages — Comparisons with other firms — Adjustments to test year figures — Electric utility.
p. 105.

3. EXPENSES, § 9

[CAL.] Ascertainment of expenses and future estimates — Adjustments to test year figures — Escalation of costs — Controllable and uncontrollable expenses — Productivity and cost containment — Electric utility.
p. 107.

4. EXPENSES, § 120

[CAL.] Electric — Production costs — Conventional steam plants — Hydroelectric plants — Engineering assessment program — Protective painting expenditures — SONGS plant — Palos Verde plant.
p. 109.

5. EXPENSES, § 120

[CAL.] Electric — Nuclear production costs — SONGS plant — Palos Verde plant — Operations and maintenance expense — Refueling costs.
p. 111.

6. EXPENSES, § 120

[CAL.] Electric — Production costs — Yuma Axis plant — Sylmar Coverter station Jointly-owned facilities — Operations and maintenance expense — Forecasted costs.
p. 115.

7. EXPENSES, § 120

[CAL.] Electric — [Distribution] costs — Supervision and engineering expenses — Storm damage costs — Underground inspection activities.
p. 117.

8. EXPENSES, § 20

[CAL.] Accidents and damages — Storm damage costs — Distribution property — Cost estimates — Electric utility.
p. 117.

9. EXPENSES, § 19

[CAL.] Customer accounts expenses — Postage costs — Methodology — Number of customer mailings as a factor — Electric utility.
p. 118.

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[*169] *Excellence," collection of incentives for nonresidential new building construction budgeted at $11.464 million. DRA recommended funding at the 1991 level of $5.118 million. We will approve Edison's requested funding.

The twelfth request is for $686,000 in modified expenses for nonresidential outdoor security lighting. Consistent with our denial of funding for residential security lighting, we will deny Edison's request.

Edison's thirteenth request is for $1.000 million of ordinary expenses for miscellaneous conservation activities. DRA recommended no funding. TURN recommended that the Commission deny $700,000 of the funding, but order Edison to use $300,000 to start a refrigerator recycling program. We will deny Edison's request altogether.

11.2.4 *Nonresidential Load Management*

Edison requested ordinary expense funding of four non-residential load management programs. The first is budgeted at $1.881 million for program expenses and bill credits for energy cooperatives, which are customer groups that agree to reduce their aggregate demand upon notice from Edison. DRA recommended funding of 50% of Edison's request, because Edison expects the growth rate of new cooperatives to decline in the test year. We will approve Edison's request.

The second load management program is for commercial and industrial air conditioner cycling, budgeted at $224,000. DRA recommended $100,000. The current funding level is $118,000. We will approve Edison's request.

The third program is for off-peak cooling, also known as thermal energy storage, budgeted at $3.980 million. DRA recommended no funding, unless individual measures show TRC ratios greater than 1.0 and incentive payments are capped at $50 per kW. DRA's opposition is due to a low TRC ratio for the program as a whole and high incentive payments, which can exceed $250 per kW. We will approve the requested $3.980 million in funding, with the condition that no incentive payments be made to projects for which the forecast TRC ratio is less than 1.0. We will not adopt DRA's payment cap. The adopted test year marginal generation, transmission, and distribution costs are approximately $82, $33, and $53 per kW per year, respectively, and thermal energy storage projects will endure for many years. An incentive payment limit of $50 per kW is not justified.

Edison's fourth request is for $387,000 to promote agricultural interruptible service. This is a new program of direct load control by Edison. No party opposed the request, and will approve it, with the condition that none of the funds are used for general advertising.

11.2.5 *Fuel Substitution, Load Retention, Load Building: General Policy*

Edison requests funding of expenses in three categories, each of which consists of several new programs, none of which were a part of the Collaborative proceeding. The categories and corresponding funding levels are: Fuel Substitution, $2.137 million; Load Building, $2.629 million; and Load Retention, $8.004 million.

We authorize Edison's funding request for each category as discussed below. We have relegated to the DSM rulemaking further consideration of the appropriate character and content of programs in the areas of fuel substitution, load retention, and load building. We have noted earlier in this decision our goal, stated in R.91-08-003/I.91-08-002, that utilities should design load building programs so as to avoid frustrating the encouragement of energy efficiency and energy conservation. We believe this holds equally for load retention programs, and we have stated a similar concern with respect to fuel substitution.[78]

Therefore, our authorization of these programs in this GRC is on a limited basis only. We preclude Edison from shifting any monies from other DSM programs into these fuel substitution, load retention, and load building programs. Moreover, we preclude the shifting of monies among these three programs. Specifically, for example, while Edison may shift monies between infrared heating and dialectic heating under the umbrella of Fuel Substitution, it may not shift monies from any Fuel Substitution program to one under the category

Re Rules and Procedures
Governing Utility Demand-Side
Management
Decision 92-02-075
R.91-08-003

Re Procedures Governing Demand-Side
Management and the Competitive
Procurement Thereof
Decision 92-02-075
I.91-08-002

California Public Utilities Commission
February 20, 1992

ORDER issuing rules governing the evaluation, funding, and implementation of demand-side management (DSM) programs and associated shareholder incentives. Basic policies are established to tap the potential of DSM to meet the commission's overall resource procurement goal; that is, to provide ratepayers with reliable, least-cost, environmentally sensitive energy service. The commission reaffirmed its commitment to head-to-head comparison of demand- and supply-side options in the resource planning process and workable competition in resource acquisition.

The rules address resource planning, resource acquisition, DSM program emphasis, cost-effectiveness testing, shareholder incentives, and improved consistency across the various regulatory proceedings that address DSM related issues. Some aspects of the adopted rules are interim, pending consideration of comments, workshop reports, and program evaluation. A separate phase of the proceedings is established for review of measurement and evaluation activities.

1. ELECTRICITY, § 4

[CAL.] Operating and efficiency — Resource procurement — Overall objective — Reliable, least-cost, environmentally sensitive energy service — Role of demand-side man-

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[*143] *ern California Gas Company (SoCal) filed applications requesting Commission authorization for expanded DSM programs and shareholder incentive mechanisms. The parties to the proceeding subsequently entered into settlement agreements, and in D.90-08-068 (37 CPUC 2d 346, 116 PUR4th 559 [1990]) and D.90-12-071 (38 CPUC 2d 507 [1990]), we approved, with some modifications, the terms of the respective settlements. Pursuant to the settlement agreements, each utility convened Advisory Committees to assist them in the implementation of the approved programs.

The shareholder incentive programs adopted in D.90-08-068 and D.90-12-071 were experimental, and were authorized through 1991 for SCE and SDG&E and through 1992 for PG&E and SoCal.[5] As we stated in D.90-08-068,"... these mechanisms should be considered experimental only and not necessarily the blueprint for the next generation of DSM program."[6] In approving these experiments, we identified the need for an OIR to provide a forum for "comparing the different DSM models ... and to assess the relative success of the different approaches." We also stated that this OIR could lead to "the development of statewide standards and benchmarks by which to measure energy efficiency and to measure the appropriate levels of incentives." To aid us in this evaluation, we directed our Commission Advisory and Compliance Division (CACD) to submit a report, by December 31, 1992, on the effectiveness of the adopted incentive mechanisms.

C. *Issuance of the DSM OIR/OII*

The issuance of our DSM OIR/OII on August 7, 1991 allows us to take up where the Collaborative left off. As we state in the OIR/OII, this proceeding will examine: (1) Collaborative positions agreed to by consensus but which are not yet formal Commission policy; (2) policy areas where the stakeholders failed to reach consensus and where resolution is critical to secure a sustained role for DSM in future utility resource procurement strategies; and (3) other important policy or technical areas not explicitly addressed in the Collaborative.[7]

Our DSM OIR/OII includes 29 proposed rules (Rules) related to utility gas and electric DSM programs. Rules 1-4 articulate policy principles for considering DSM programs as viable alternatives to traditional supply-side resource options, and present common terms and definitions. Rules 5-13 provide guidelines for the cost-effectiveness testing of DSM, and establish priorities among different types of DSM programs. Rules 14-19 adopt interim principles governing future shareholder incentives, pending CACD's report. Rules 20-25 address the role of measurement and evaluation in DSM program development. They also discuss the need for consistent treatment of DSM programs across utilities and across regulatory forums. In Rule 25 we propose establishing a single forum where all utilities' DSM activities can be reviewed, and ask for comments on that proposal. Rules 26-29 provide guidance on the development of DSM pilot bidding programs. A copy of the Rules, as originally proposed, is appended to this order. (See Attachment 3.)

Comments on the Rules were filed on September 23, 1991 by PG&E, SCE, SDG&E, SoCal, Southwest Gas Corporation (Southwest), Division of Ratepayer Advocates (DRA), California Energy Commission (CEC), South Coast Air Quality Management District (SCAQMD), California Department of General Services (DGS), United

States Department of Defense (DOD), Natural Resources Defense Council (NRDC), Toward Utility Rate Normalization (TURN), Utility Consumers' Action Network (UCAN), California Large Energy Consumers Association (CLECA), California Manufacturers Association (CMA), National Association of Energy Services Companies (NAESCO), SYCOM Enterprises (SYCOM), and Transphase Systems, Inc. (Transphase).[8]

After comments were filed, various parties decided to meet informally to discuss the proposed rules and their comments to those rules. By letter to the assigned administrative law judge (ALJ), dated December 10, 1991, representatives from SCE, PG&E, SDG&E, SoCal, DRA, CEC, CLECA, DGS, NAESCO, and NRDC presented their consensus recommendations for amending the Rules, and identified areas where no consensus could be reached. A
[*144] *copy of this letter was served on all parties to this proceeding.

III. *Utility Resource Procurement: Where We Are Heading*

Utility resource procurement involves both planning and acquisition. Resource planning determines whether the utility needs to acquire new resources, in order to maintain reliability and/or to improve the efficiency of the utility system. This determination is made by comparing the total costs of the utility's resource plan before and after adding supply- or demand-side resource options. Resource acquisition, on the other hand, determines how the utility will acquire the new resources that are needed, as identified in the planning process. The utility can construct new plants, purchase power from other utilities, offer DSM programs to its customers, or purchase power (or DSM services) from unregulated third parties. Competitive bidding enables utilities and third parties to compete in the resource acquisition

process, for the purpose of putting downward pressure on the costs of energy services.

[1, 2] As stated in our Rules, our overall objective for utility resource procurement is reliable, least-cost, environmentally sensitive energy service.[9] All parties support this objective. However, they offer different views on how to achieve that objective. In particular, parties' comments highlight two fundamentally different views on how DSM should fit into the planning stage of utility resource procurement.

The first view is that utility DSM programs should be funded whenever they reduce the total costs of the system (defined to include environmental impacts). For example, NRDC argues that the way to achieve our resource procurement goals is to "favor demand-side measures over supply-side alternatives whenever life-cycle costs, including environmental costs, can be reduced in the process." Similarly, SoCal suggests that the reference point for DSM program funding be the level of cost-effective DSM that can be achieved on a utility's system. In practice, this approach establishes a DSM "set-aside," where a utility's need for resource additions would first be reduced by implementing all potential cost-effective DSM.

Under this approach, any remaining need for resource additions is met through a least-cost planning and acquisition process for supply-side resources only. This includes bidding by qualifying facilities (QFs) and other non-utility generators (NUGs) for the supply-side resources identified in the process.[10] DSM bidding could also take place, but only within the set-aside framework, i.e., energy service companies (ESCOs) would bid for a portion of the DSM set-aside, either to replace or augment utility DSM efforts.

The second view is that demand- and supply-side resources should be compared head-to-head for cost-effective-

ness, including relative environmental impacts. Once the optimal mix of utility DSM and supply-side options is identified in the planning process, some or all of those options would then be put out for bid by third parties. In their comments, some parties indicate a preference for an acquisition process that segregates the bidding arena, allowing ESCOs to bid only for DSM options and NUGs only for supply-side options. Others prefer an "integrated" bidding process, with ESCOs and NUGs competing together for all resource needs.

The first view describes our current resource procurement framework. In our Biennial Resource Plan Update proceeding (Update), we essentially develop a DSM set-aside, based on the California Energy Commission's forecast of cost-effective DSM activities that are not currently included in utility DSM funding authorization. Once the demand forecast is adjusted for this amount of "uncommitted DSM," we proceed to test all utility supply-side options, side-by-side and year-by-year, to see if the total costs of the system can be reduced further. We refer to this testing process for supply-side resources as the Iterative Cost-Effectiveness Method (ICEM). Using ICEM, the quantity and price of supply-side resource additions are identified in the planning process. The resulting resource plan creates the baseline for long-run marginal costs of electricity.[11]

As we've acknowledged in the past, our current planning
[*145] process is somewhat limited in *its ability to produce an optimal mix of resources in the system, for it does not include DSM programs in the iterative analysis of cost-effectiveness. Our current approach does not necessarily allow us to determine whether ratepayers might receive greater benefits from, for example, a renewable resource than from additional DSM programs, and vice versa. In addition, the current approach does not accommodate the optimal sequencing of investments in demand- and supply-

side resources. By achieving our goal of comparing supply- and demand-side options on an equal footing, we hope to ensure such optimization. As we stated in D.91-06-022 (122 PUR4th 181 [1991]), and reiterated in our OIR, "we are committed to head-to-head comparison of DSM and supply options in the planning process, and perhaps ultimately in the bidding process as well."[12]

We are moving in this direction in several ways. First, we are testing the capabilities of analytic tools to directly integrate DSM programs into our current planning process for supply-side resources. In the current phase of the Update, SDG&E has used ICEM to integrate DSM into its resource plan. Demonstrations for PG&E and SCE are underway. These efforts should illuminate what factors are involved in directly comparing DSM and electric supply options, and the advantages and limitations of ICEM in making that comparison. On the gas side, we are committed to moving forward with our objectives in as many ways as practicable, as we await the outcome of implementation hearings in our marginal cost proceeding (I.86-06-005) (22 CPUC 2d 444, 79 PUR4th 93 [1986]).

Second, we have made considerable progress in the way we account for nonprice factors associated with both demand- and supply-side resources. Our recent decision in Phase 1B of the Update established preliminary values for residual emissions of air pollutants. (See D.91-06-002.) As part of our transmission Investigation (I.90-09-050), we are examining ways to incorporate transmission and distribution costs into the planning process. By explicitly valuing these factors, we can better appreciate the full range of costs and benefits associated with supply- and demand-side resources.

Third, on the acquisition side, we have steadily introduced competitive bidding in order to put downward pressure on the costs of energy services. We already have a competitive bidding process in place for QFs, and are currently working

towards widening the bidding arena to include other NUGs in the Update and transmission Investigation.[13] On the supply side, QFs compete with the utility for the least-cost resource additions, as identified in the planning process. If the QF's bid is lower than the utility's planned cost-effective addition, then the QF wins the bid and builds its own project. If QFs cannot beat the utility's costs, then the utility builds the addition identified in the planning process.

As part of this OIR/OII, we are also initiating pilot DSM bidding programs to test the potential for achieving energy savings through a competitive market. Pursuant to Public Utility (PU) Code § 747, we will experiment with DSM-only bidding pilots, as well as integrated bidding, where demand- and supply-side options compete in a single arena. These bidding experiments will help us learn more about alternative DSM delivery mechanisms, and assess the role of DSM bidding to provide least-cost DSM services to ratepayers.

Finally, as stated in our OIR, we are working towards a procurement framework that gives the utility comparable incentives to meet its least-cost resource needs through demand-or supply-side resources. We want to ensure that neither our regulatory framework nor procedures contain any inherent biases that inhibit utility management from actively pursuing the optimal mix of demand- and supply-side resources. To this end, we established a pilot program of shareholder incentives for gas and electric DSM programs in D.90-08-068 (37 CPUC 2d 346 [1989]). We are in the process of evaluating the various shareholder incentive mechanisms now in place, and will report our findings to the Legislature by the end of 1992. In the meantime, we will continue to examine implementation issues related to these incentive programs, as they arise in these and other ongoing proceedings.

[*146] The above discussion serves as a backdrop *to our consideration of comments filed in this proceeding. Not all parties share our vision of where we are heading in resource procurement: towards head-to-head comparison of demand- and supply-side options in the planning process and workable competition in resource acquisition. As a result, many of the comments to the specific rules reflect a different vision of the future. At the same time, some commenters agree with where we are heading in resource procurement, but suggest that we move faster in making changes to our current framework. As described above, we are committed to achieving our objectives in a careful, deliberate manner. without losing sight of our goals, we will structure our rules to accommodate new information, as we gain experience with shareholder incentives, DSM bidding, and other aspects of integrated resource planning and acquisition. We aim to make all aspects of our resource procurement process, including the evaluation and implementation of DSM, and predictable as possible.

IV. *Major Issues*

We turn now to the major issues raised in parties' comments to our proposed rules. This summary highlights the range of debate and proposed modifications. It is not intended to be a comprehensive description of all points raised by commenters. We believe that the saving of space and the gain in clarity justify using an overview. For reference, we present the full text of our proposed Rules in Attachment 3.

A. *Measurement and Evaluation*

We begin with the issue of measurement and evaluation (M&E) of DSM savings because it represents, in our view, the threshold issue for our regulatory oversight of DSM programs. All parties agree, in principle, that M&E must be emphasized as a priority. However, parties differ on how to establish this priority, what specific M&E activities should

be required, and how M&E activities should be linked to shareholder incentives. (See Rules 20 to 22 in Attachment 3.)

1. *Two General Observations*

In addressing parties' comments, we make two general observations. First, parties raise concerns about M&E-related issues in response to all aspects of our proposed rules, not just the rules specific to M&E. For example, SDG&E, NRDC, and others react to our proposal for an earnings cap (as a method of reducing ratepayer risk) by recommending that we instead reduce ratepayer risk "at the source" through improved M&E activities. In response to our stated preference for a shared savings approach to shareholder incentives, SoCal argues that other approaches that do not rely as heavily on savings estimates might be preferable, given the uncertainty over the reliability of those savings.

Concerns over M&E are also raised in response to our proposed rules on cost-effectiveness testing for DSM programs. For example, CMA argues that our preference for the Total Resource Cost (TRC) test requires a "leap of faith" that future savings in supply-related costs will justify today's expenditures. On the topic of incentive payments, several parties recommend that those payments be based on the results of M&E activities, rather than on advance engineering estimates, in view of the uncertainties associated with future savings. Parties also raise the issue of M&E in conjunction with DSM bidding pilots: DGS and others recommend that M&E requirements for bidders apply equally to the utilities. Finally, several parties comment on the importance of M&E activities in improving long-term forecasts of DSM savings. In sum, parties identify M&E as a critical element in all aspects of the rulemaking.

Our second observation is that we currently lack an identified regulatory forum for evaluating M&E protocols,

reviewing the results of M&E activities and considering methods for incorporating M&E results into the next generation of DSM programs and forecasted savings. To date, these types of M&E activities have been conducted informally, starting with the Collaborative process. During the Collaborative, a technical subcommittee developed proposed M&E protocols for the utilities' experimental incentive mechanisms, and submitted them as part of the Blueprint. Protocols similar to these were included in the settlement

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[*152] *posed modifications to the DMS program terms and definitions presented in Attachment 1 to ensure that they are consistent with these principles. With the policy guidance provided in this order, we expect that parties can reach consensus on most recommended changes.

In its workshop report, CACD should describe all proposed modifications to DSM program terms and definitions, indicate which are agreed to by all workshop participants, and describe any outstanding issues. CACD's workshop report shall be filed with the Commission's Docket Office and served on all parties within 120 days of the effective date of this order. As stated in Rule 4, the Reporting Requirements Manual will be modified to reflect the final version of DSM program terms and definitions. The assigned ALJ will direct these efforts after receiving CACD's report.

C. *Cost-Effectiveness Indicators for DSM Programs*

The Rules on DSM cost-effectiveness indicators are closely related to the rules on DSM funding priorities, described above. In particular, Rule 6 directs utilities to rely on the Total Resource Cost (TRC) test as the primary indicator of DSM program cost-effectiveness because that test "reflects our view that utility DSM activities should

focus on programs that serve as alternatives to supply-side resource options." At the same time, Rule 11 acknowledges that the usefulness of the TRC test is limited to direct assistance, information, and energy management services programs. For these programs, our Rule 11 states that the TRC test should be an important, but not the sole, factor used to determine funding levels.

The Rules also speak to the mechanics of conducting cost-effectiveness tests for DSM programs. Rule 5 directs utilities to use the methods and indicators included in the *Standard Practice Manual (SPM),* until a methodology is established that allows for the side-by-side comparison of demand- and supply-side resources. Rule 7 states that utilities should include nonprice factors along with price factors in considering DSM programs, and directs utilities to use any nonprice factors developed in the Update proceeding that are applicable to DSM evaluation. Rule 8 also directs utilities to use resource values (i.e., avoided supply costs) in their DSM cost-effectiveness tests that are consistent with the values adopted in the Update. Rule 9 states that utilities should not be required to include any indirect costs of DSM in their analyses at this time, given the speculative nature of attempts to quantify those costs. Rule 10 directs utilities to include the costs of shareholder incentives in each of the SPM tests of cost-effectiveness. (See Attachment 3.)

1. *Position of the Parties*

Parties generally agree that the SPM methods and indicators are appropriate for the cost-effectiveness testing of DSM programs, at least in the short-run.[25] This is not surprising, given the long history of using these tests in various proceedings at this Commission and the CEC. Only CMA argues that the SPM tests of cost-effectiveness are

inappropriate. In CMA's view, none of these tests adequately account for the impact of DSM programs on rates.

With regard to our primary reliance on the TRC test, most parties agree that this emphasis is appropriate for DSM resource programs (i.e., programs designed to avoid or defer supply side resources). However, NRDC urges the Commission to use the societal test instead, because it accommodates the inclusion of environmental costs. Transphase believes that the Utility Cost test is preferable, since it excludes customer costs from the cost-effectiveness evaluation. CMA argues that the TRC is inadequate because it ignores near-term rate impacts. TURN and DOD urge the Commission to continue to assess the rate impacts of all DSM programs, and take those impacts into account when considering DSM program funding. SDG&E, DRA, and SoCal recommend that the TRC test be relaxed for New Construction programs, in addition to the direct assistance, information and energy management services programs mentioned in Rule 11.

On the topic of nonprice factors most parties agree that these factors should be incorporated in the cost-effectiveness analysis of DSM, and should be consistent with the values [*153] *developed in our Update proceeding.[26] Similarly, parties agree that the resource value associated with DSM programs should be consistent with the avoided costs adopted in the Update proceeding. PG&E, CEC, and Transphase recommend, however, that deferred transmission and distribution costs be included as part of that resource value.

All parties agree with the current framework which allows, but does not require, inclusion of DSM indirect costs in cost-effectiveness testing. SCE and CEC suggest that the SPM working group revisit this issue in the future.[27] SDG&E would have the SPM working group also address whether or not utility shareholder incentives should be included in the Societal Test. All other parties agree with

Rule 10, which includes shareholder incentives as costs in all *SPM* tests.

2. *Discussion*

[8] Before addressing the specific issues raised in parties' comments, we present a brief backgroup on the *SPM* manual and various tests of cost-effectiveness.

a. *SPM Tests of Cost-Effectiveness*

The *SPM* is a joint CEC/CPUC staff publication that presents a cost-benefit methodology for the evaluation of DSM programs. It is the product of workshops among the staffs of the CEC and this Commission, the major utilities, and interested parties. Originally published in February, 1983, the *SPM* was modified in December 1987.[28]

The *SPM* outlines cost-benefit equations for four major perspectives; the program participant (Participant Cost, or PC), the utility, in terms of its revenue requirements (Utility Cost Test, or UC), the total costs of the program, including utility and participant costs (Total Resource Cost, or TRC) and the change in rate levels (Rate Impact Measure, or RIM). The Societal Test, or ST, is a variation of the TRC that considers total costs and benefits from society's perspective as a whole, rather than just the utility and its ratepayers.

The *SPM* cost-benefit equations are considered static (as compared to dynamic or iterative) tests of cost-effectiveness. This is because they compare each DSM program against the utility's resource situation at a single point in time. Static tests of cost-effectiveness will indicate whether a resource option is cost-effective (i.e., lowers system costs), assuming all other things remain equal. In contrast, an iterative approach chooses from among cost-effective options to determine which are the *most* cost-effective to add to the utility system, taking into account the type, size, and

timing of potential additions. As we discuss in Section III above, we are examining methods to iteratively assess both demand- and supply-side resources. In the meantime, we will use the *SPM* tests of cost-effectiveness in ways that are the most consistent with our resource procurement goals. Each of the *SPM* tests is described in greater detail below.

(1) *Participant Cost Test (PC)*

Analysts use the PC test to measure the benefits and costs of a program to a customer. This test compares the reduction in the customer's utility bill, plus any incentive paid by the utility, with the customer's out-of-pocket expenses. It gives a good "first cut" of the desirability of the program, and is used as an indication of potential participation rates.

(2) *Utility Cost Test (UC)*

The UC test measures the net change in a utility's revenue requirements resulting from a DSM program. The *SPM* describes the benefits for this test as "the avoided supply costs of energy and demand — the reduction in transmission, distribution, generation, and capacity costs valued at marginal cost — for the periods when there is a load reduction." The costs for the UC are the program costs incurred by the utility, the incentives paid to the customers, and the increased supply costs for the periods in which load is increased. Since the test is designed to focus on revenue requirements, it does not include any net costs incurred by program participants.

[*154] *(3) *Total Resource Cost Test (TRC)*

The TRC test measures the net costs of a DSM program as a resource option based on the total costs of the program, including both the participants' and the utility's costs. The benefits side of the equation is the same as the UC test, described above. The costs in this test are the total equip-

ment or measure costs, including installation, operation, and maintenance and administration, no matter who pays for them. In addition, costs for this test include the increase in supply costs for the periods in which load is increased. The ST variation is structurally similar to the TRC, but includes broader societal impacts, such as the externality costs of power generation not captured in the market system.

(4) *Rate Impact Measure Test (RIM)*

The RIM test indicates the direction and magnitude of the expected change in customer bills or rate levels. On the benefits side, the RIM test calculates the savings from avoided supply costs similar to the UC and TRC tests described above. On the cost side, the RIM test incudes the costs incurred by the utility (including incentives paid to the participant). Up to this point, the RIM test looks identical to the UC test.

However, the RIM test also includes a rate effect that is unique to DSM programs. Unlike supply-side resources, DSM programs cause a direct shift in revenues. In other words, when DSM programs reduce energy sales, a utility's fixed costs must be spread over a smaller sales volume (or a larger sales volume in the case of load building programs). This revenue shift does not affect total revenue requirements (as measured in the UC test), but does raise utility rates on a cents per kwh basis. The revenue shift effect may be offset by the cost savings that ratepayers realize in avoiding supply-side options. The net effect depends on the relationship between average costs and marginal (or avoided) costs. As a general rule, if average costs are expected to exceed marginal costs into the future, then the program is likely to increase utility rates. This is generally the case when a utility system has excess capacity, e.g., it has recently ratebased a "lumpy" plant investment. If, however, marginal costs are expected to exceed average costs (e.g., the utility needs to

build new resources), the net effect is likely to be a reduction in utility rates. The overall effect on a customer's bill depends on whether or not they are past, current or future participants in energy efficiency programs.[29]

b. *Which Test to Favor?*

[9] We remain committed to using the TRC as the primary indicator of cost-effectiveness for DSM programs. This is consistent with our stated policy of emphasizing DSM programs that serve as long-term alternatives to supply-side resources. It is also consistent with the least-cost planning principles that we apply to supply-side resources. In that context, we compare the total resource costs of the supply system, with and without the incremental resource addition. If inclusion of the new resource lowers total costs more than any other supply-side option, then it is considered cost-effective, and added to the resource plan. The TRC test does the same thing, although in a static sense, for DSM programs. As described above, the TRC test is the only *SPM* test of cost-effectiveness that looks at the total resource costs of DSM, regardless of who pays for the measure or equipment.

[10] The UC test, on the other hand, only considers the portion of the DSM measure or equipment cost that is paid for by the utility. For most DSM programs, the utility cost is significantly less than the full resource cost. In contrast, all of the costs of supply-side resources are traditionally paid for by the utility, on behalf of its ratepayers.[30] Hence, funding DSM programs on the basis of the UC test would lead to the inefficient allocation of resources, since investments would be based on an evaluation of only a portion of total costs. It would also bias resource planning decisions in favor of DSM, relative to supply-side resources. Both of these results are contrary to our resource procurement objectives.

For these reasons, we reject Transphase's recommendation that the UC test be favored.

[*155] *[11] For similar reasons, we find the RIM test inappropriate as the primary indicator of DSM cost-effectiveness. Like the UC test, the RIM test only looks at a portion of the total costs of DSM programs, i.e., the portion reflected in utility revenue requirements. Therefore, the RIM test does not identify least-cost resource options, from an economic efficiency perspective.

Moreover, the results of the RIM test are affected by the *rate-making* treatment for DSM programs, that is, the way in which program costs are recovered in rates. For example, a DSM program that lowers total costs over the program life could still increase rates initially because the costs associated with that program are recovered relatively quickly, e.g., over the first few years of the program. At the same time, a more expensive DSM program could have a lower rate impact just because cost recovery is stretched over a longer period of time. While the RIM test gives us useful information about the overall rate impact of resource procurement decisions, or the affect of various ratemaking approaches on rates, it does not accurately compare the economic costs of resource options.

For the above reasons, we do not compare the rate impacts of various supply options in deciding which is the least-cost resource to add in a given year. If we did, we would probably favor all supply options for which the ratemaking treatment was less front-load than utility-constructed plants. Moreover, if we only funded cost-effective supply-side resources that also reduced utility rates in the short term, we probably wouldn't fund a single one. Just like DSM programs, almost all investments in supply-side resources increase rates initially, as those costs are recovered at a rate that is higher than avoided costs during the early years of the project.[31] Ranking resource options primarily on

the basis of relative rate impacts rather than total costs, whether those options are supply-side options or DSM programs, would be contrary to our least-cost planning principles.

We also note that, because of the revenue shifting characteristic of DSM, primary reliance on the RIM test would tend to promote programs that increase (re retain) electric and gas sales. While this may result in slightly lower rates in the short to medium term, it will not reduce the costs of the supply system (and customer bills) in the longer term. This is particularly true for utilities that will require resource additions over the next decade. Based on the base case filings in our Update proceeding, this appears to be the case for the three major electric utilities, PG&E, SCE, and SDG&E.

For the reasons stated above, we retain the use of the TRC test as the primary indicator of cost-effectiveness in ranking and funding DSM programs, as we proposed in our Rules. We direct utilities and other parties to our proceedings to use the TRC test for this purpose. NRDC's concerns about using the TRC, rather than the ST variation, are addressed by our clear direction to include nonprice factors, such as environmental externalities, in developing avoided supply costs. Moreover, the ST variation treats certain cost components as transfers (e.g., tax credits and interest payments). We prefer to treat those components as explicit resource costs, as we do in evaluating supply-side options.

While we clearly favor the TRC test for ranking and funding DSM programs, strict TRC adherence is not required for direct assistance programs, information programs and energy management services (see Rule 11). The workshops on DSM program terms and definitions, described in Section IV.B. above, should also explore the cost-effectiveness issues raised by DRA, SDG&E, and SoCal with regard to New Construction Programs.[32]

As we stated in the Order Instituting this rulemaking, our preference for the TRC test does not diminish the importance of the information provided by the other indicators included in the *SPM*.[33] We plan to use these other indicators in considering the appropriate level of DSM funding in a given period, e.g., in deciding how far down the TRC-ranked program list to go in establishing an overall DSM budget. We also note that the rate impact of DSM programs, as measured by the RIM test, is affected by the size of the utility incentive to participants, the level of utility administration costs (including shareholder incentives), and the overall timing of rate recovery for those costs. We will
[*156] consider the effect of these *design parameters on rates, as we evaluate respondents' specific DSM program proposals. According, we retain the language in Rules 5 and 23 that requires utilities to provide information on the other *SPM* tests and, in particular, on the rate affects of DSM programs.

c. *Avoided Cost Assumptions*

As described above, Rules 7 and 8 require that, in applying the *SPM* tests of cost-effectiveness, parties use avoided supply costs (or "resource values") and nonprice factors that are consistent with the values adopted in our Update proceeding.

(1) *Consistency with the Update*

By ruling dated September 12, 1991, the assigned ALJ requested further comment on how to implement these principles. Supplemental comments were filed on October 21, 1991 by SCE, SDG&E, PG&E, SoCal, DRA, and Henwood Energy Services, Inc. (HESI). HESI's comments were filed on behalf of the Geothermal Resources Association and the Independent Energy Producers.

In their supplemental comments, parties offer a wide range of methods for using Update planning or modeling outputs to derive the long-run avoided costs required for the *SPM* tests. We agree with SDG&E and others that specific proposals for ensuring consistency should first be explored in workshops. We therefore direct CACD to conduct workshops for the purpose of (1) discussing the specifics, similarities, and differences of each party's proposal and (2) narrowing the issues for further Commission consideration in these proceedings.

In addition, as discussed in Section IV.F. below, parties should address the relationship between the DSM elements of our current resource planning framework and the subsequent funding of DSM programs.[34] These workshops should follow shortly after issuance of a decision on deferrable resources in the resource plan phase of I.89-07-004. CACD's workshop report should be filed and served on all parties to this proceeding and the Update on or before November 1, 1992. As SoCal points out, the avoided cost of electric generation (developed in the Update proceeding) does not apply to a gas-only utility. We will continue to rely on approximations of long-run marginal gas costs as we await the outcome of implementation hearings in I.86-06-005.

(2) *Transmission and Distribution (T&D) Costs*

[12] We agree with PG&E, CEC, and Transphase that avoided T&D costs should be accounted for in evaluating DSM cost-effectiveness, just as similar avoided costs should be considered in comparing supply-side options. However, this raises the fundamental issue of how to quantify the avoided (or increased) T&D costs associated with resource options. We do not explicitly include avoided transmission costs in our determination of avoided supply costs in the Update, because we do not yet have adequate information to

assess the impact of QFs on the utility's transmission system.

However, as we describe in D.91-10-048 (130 PUR4th 17 [1991]), we are setting up a process whereby this type of information will be readily available. More specifically, utilities will compile and publish transmission information on a two-year cycle, as part of the ER/Update process. This information will include current and anticipated loads, line losses, transmission capacity considered to be available now and in the future, plans for upgrades, and estimated cost of upgrades. As stated in D.91-10-048, utilities will be required to use the same projections, costs, analytical techniques, etc., in planning for their own supply-side resources.[35]

The use of consistent, published data is equally appropriate for DSM resource procurement. We expect utilities to use the published transmission information described above the purpose of quantifying any avoided T&D costs associated with specific DSM programs. As part of the workshops on avoided cost consistency, parties should identify the types and sources of distribution cost data that will also be needed
[*157] for this purpose. We will continue to *define "resource value" as stated Rule 8, until we have established a track record of incorporating T&D information into the Update process.

d. *SPM Working Group*

In developing the original and revised versions of the SPM, the staffs of the CPUC and CEC formed an informal working group that included most of the major utilities in California and other interested parties. In their comments, parties generally agree that the *SPM* working group is an appropriate forum for technical issues related to the *SPM* cost-effectiveness tests, such as the quantification of indirect costs. We would like to see the *SPM* working group continue, and encourage parties to use this forum for informally

addressing these types of ongoing technical issues. We agree with SDG&E that the appropriate treatment of shareholder incentives in the Societal test should also be considered by the *SPM* working group. All future updates or modifications to the *SPM* based on these ongoing meetings, should be filed in this docket and served on all parties.

D. *Shareholder Incentives*

Shareholder incentive for utility DMS activities are addressed in Rules 14 through 19. Rule 14 states that the utility should be provided a "comparable" opportunity for earnings from prudent investments in both demand and supply-side resources, and that shareholder incentives can help ensure this comparability.[36] Rule 15 acknowledges that CACD will be reviewing the experimental incentive mechanisms that were adopted in D.90-08-068 for the 1990-1992 period. Until the results of that study can be reviewed, Rule 15 proposes that a limited number of principles be adopted to govern future shareholder incentives. Rule 15 also states that we expect the shareholder incentive mechanisms to eventually converge toward a more uniform, statewide approach.

Rules 16 through 19 outline general principles for governing shareholder incentive mechanisms, pending CACD's report on shareholder incentives. These principles can be summarized as follows:

- Load building and load retention programs should not be eligible for shareholder incentives. Fuel substitution programs should also be ineligible until technical issues associated with assessing ratepayer benefits are resolved.[37] (Rule 16)

- Any proposed shareholder incentive mechanism should include minimum performance requirements and accompanying penalty features. (Rule 17)

- Shareholder incentive mechanisms should be based on a shared-savings approach for programs whose savings can be reasonably estimated. (Rule 18)

- A mechanism should be established to limit the level of potential shareholder earnings from DSM, keeping in mind the "comparable earnings" guideline. (Rule 19)

In their comments, parties presented a wide range of views regarding Rules 15 through 19, both in terms of the general role of shareholder incentives, as well as the specific form of those incentives. We discuss these views, by issue, in the following sections.

1. *The Role of Shareholder Incentives*

[13] TURN, DOD, and UCAN urge the Commission to await CACD's report, before concluding that shareholder incentives are necessary or appropriate on a permanent basis. In their view, CACD's review of the various shareholder incentive mechanisms should include an examination of the underlying assumption that shareholder incentives are required to stimulate DSM. In particular, UCAN suggests that CACD examine, among other things, the development of a private marketplace in energy efficiency, which may replace the need for incentives for those services.

Neither the Collaborative process nor our consideration of the incentive programs adopted in D.90-08-068 yields conclusions concerning the longer-term role of DSM shareholder incentives. As acknowledged in the *Blueprint,* Collaborative stakeholders were split on this issue.[38] Similarly, in adopting the settlement agreements

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[*184] *Footnotes

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[5]SCE's incentive program was reevaluated, and modified on an interim basis, in its recent general rate case decision, D.91-12-076 (130 PUR4th 97 [1991)]; SDG&E's experimental incentive mechanism was extended through 1992 as part of its 1992 modified attrition (see D.91-12-074 in Application 91-03-001).

[6]D.90-08-068 (37 CPUC 2d 347, 362, 116 PUR4th 559 [1990]).

[7]OIR/OII, August 7, 1991, p.7.

[8]Kenetech Energy Management, Inc. (Kenetech) also filed comments, but they were late-filed (October 8), and did not include a certificate of service or service list. While we do not explicitly consider Kenetech's comments in this order, we note that the comments of serveral other parties reflect similar views.

[*185] *[9]As DRA and others point out in their comments, Rule 1, as originally proposed, refers only to "electricity service." (See Attachment 3.) We correct the language of Rule 1 to read "energy service" in our adopted rules. (See Attachment 1.)

[10]QFs are the subset of NUGs that satisfies various efficiency and technology criteria established under the Public Utility Regulatory Policies Act (PURPA) of 1978.

[11]To date, we have only developed a general methodology for estimating natural gas long-run marginal costs. Implementation hearings in I.86-06-005 will begin in late summer/early fall of 1992.

[12]See D.91-06-022, mimeo., pp. 10-11 (124 PUR4th 181 [1991]).

[13]For the purpose of this OIR/OII, we use the term "all-source bid" to refer to a bidding arena where all types of NUGs (not just QFs) can bid against utility supply-side resources, as identified in the planning process. We use the term "integrated bid" to refer to a bidding arena where providers of DSM services and NUGs can bid against utility demand- and supply-side resources alike.

* * *

[*186] *[29]Contrary to CMA's assertions, the RIM test does indeed take account of the revenue shift and rate effects discussed in its comments.

[30]In other words, we do not identify individual ratepayers who, because they "caused" the need for new generating resources, should pay a greater portion of the incremental plant than other ratepayers. For electric utilities, the costs of new plant are spread to all ratepayers, old and new. By definition, there are only utility costs (and no participant costs) for supply-side options. This is also true for the bulk of a gas-utility's customers (i.e., core or core-subscription), where the utility pays for all the costs of supply-side resources on behalf of its ratepayers.

[31]Exceptions include payments to QFs under "as available" standard offer contracts and out-of-state power purchase agreements that similarly track avoided costs over their contract lives.

[32]New Construction Programs are designed to encourage the installation of new efficiency measures that go beyond existing CEC efficiency standards for new building.

[33]OIR/OII, August 7, 1991, p. 16.

[34]See also the next Section.

[35]See D.91-10-048, mimeo., pp. 9-10 and 32-35.

[36]Rule 14 also states that the introduction of balancing account treatment for electric sales and gas throughout has removed the disincentive for utilities to invest in DSM. In its comments, SoCal argues that disincentives due to gas throughout fluctuations still exist on the gas side, for both the core and noncore markets. We will explore this issue in a later phase of this proceeding, once CACD's overall evaluation of DSM incentives has been completed. In the meantime, we will acknowledge that disincentives may still exist on the gas side by modifying the language in Rule 14.

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Re Rules and Procedures
Governing Utility Demand-side
Management

Decision 92-09-080
R.91-08-003

Re Demand-side Management and the
Competitive Procurement Thereof
Decision 92-09-080
I.91-08-002

California Public Utilities Commission
September 16, 1992

ORDER approving pilot demand-side management (DSM) initiatives proposed by San Diego Gas & Electric Company, Southern California Gas Company, and Southern California Edison Company, each of which would incorporate a type of "partnership bidding approach" whereby energy service firms would compete and bid for DSM programs that replace (rather than augment or enhance) existing and planned utility DSM activities.

Commission provides bid evaluation and cost-effectiveness criteria, and authorizes flexibility in accounting for and funding of the DSM programs. The three utilities are required to solicit bids for 20% to 30% of their 1992 planned DSM activities.

San Diego Gas & Electric is authorized to bid out its residential appliance efficiency program, and is granted a targeted funding level of $19.6 million. Southern California Gas is directed to expand applicability of its DSM plans to single-family residential customers, and is granted a targeted funding level of $13.66 million. Southern California Edison is instructed to enlarge its DSM programs to encompass

industrial and large commercial customers, and is granted a targeted funding level of $35.4 million.

In an earlier companion order, the commission had approved a pilot DSM bidding program for Pacific Gas & Electric Company, the only difference being that that plan used competitive bids to augment and enhance (rather than replace) the utility's own DSM activities. For that earlier order, see 131 PUR4th 559 (Cal. P.U.C. 1992).

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1. CONSERVATION, § 1

[CAL.] Demand-side management (DSM) programs — Competitive bidding — By energy service firms — To replace utility DSM activities — Framework — Not the same as for supply-side resource plans — Economic factors not sole criteria — Exact matching of utility's size and load characteristics not required.
p. 377.

2. CONSERVATION, § 1

[CAL.] Demand-side management (DSM) programs — Competitive bidding — By energy service firms — To replace utility DSM activities — Framework — Consideration of shareholder incentives.
p. 380.

3. MONOPOLY AND COMPETITION, § 22

[CAL.] Restraint of trade — Antitrust laws — Exceptions — Authority of state commission to place limits on competition.
p. 386.

* * *

[*386] *program is not feasible, in SoCal's opinion, until several questions are resolved. These include questions about who should administer the program, how costs are shared, which

measures would be eligible for bidding, and who would do the work. (TR at 794, 823, 893.)

5.2.6 *Discussion*

Parties to this proceeding have raised threshold antitrust issues that need to be addressed before turning to the specifics of how to design these bidding pilots. Accordingly, we address those issues first, in Section 5.2.6.1 below. In Section 5.2.6.2, we address parties' specific proposals for the design and size of the pilots and present our determinations.

5.2.6.1 *Antitrust Issues*

[3] Federal and state antitrust laws prohibit entities from unreasonably restraining trade, or conspiring to restrain trade in the private sector.[16] However, these laws do not prohibit states from imposing restraints on competition. The "state-action doctrine," as established by federal courts, grants antitrust immunity for state regulatory programs and actions taken by private parties in response to state directives. The courts have generally granted antitrust immunity under this doctrine if the alleged anticompetitive behavior meets a two-prong test: (1) the state must have clearly articulated and affirmatively expressed a policy of restraining trade, and (2) the state must actively supervise the enforcement of that policy.[17]

As we recently reiterated in D.91-05-028, "competition is one of the factors bearing on the exercise of this Commission's discretion, and one of the facts that must be considered in its decisionmaking process." (D.91-05-028, mimeo., p. 20; *Northern California Power Agency v. Public Util. Commission* (1971) 5 Cal.3d 370.) DRA and Transphase rightfully point out that the consideration of competition is particularly pertinent to our oversight of utility activities in the DSM market. By enacting Chapter 984 of the Statutes of 1983, the Legislature stated its intention that public

utility regulations be clearly based on the principle that the energy conservation industry should be allowed to develop in a competitive manager.[18]

Since 1975, by our own initiative and by legislative mandate, utilities have used ratepayer funds to promote DSM as a cost-effective alternative to traditional supply-side resources.[19] Our own policies have echoed the Legislature's intent to foster a competitive market in DSM services.[20] To this end, we have authorized utilities to initiate programs that reduce the informational and financial barriers inhibiting the implementation of cost-effective DSM in the private market. Through ratepayer-funded DSM programs, utilities have provided energy audits to its customers, targeted DSM information to relevant retail and wholesale decisionmakers, and provided DSM financial incentives to reduce the investment payback to customers. These programs were authorized with the intent of fostering competition, not inhibiting it. Given the clear language of Chapter 984, we find no merit to SDG&E's argument that, for DSM programs in general, utilities are immune under the state-action doctrine from antitrust violations in the DSM market.

[4] At the same time, we disagree with Transphase that the pilot bidding programs must encompass all or substantially all of the utilities' annual DSM funding in order to comport with legislative intent. Transphase's arguments are based on two unsupported assertions. The first is that utilities are currently using their access to ratepayer funds in a manner that is anticompetitive and detrimental to ratepayers. The second is that the best way to rectify this situation is to move to full implementation of DSM bidding.

Transphase has failed to present sufficient evidence to support its allegations that utilities are restraining competition and imposing unnecessarily high costs on ratepayers in the process. The mere fact that a utility offers relatively low

rebates for a cost-effective DSM investment is not sufficient evidence that the utility is manipulating the market. The utility might not offer larger rebates because the incremental savings from that additional expenditure may be relatively low. Or, shifting dollars into another cost-effective DSM program may yield higher net resource benefits to ratepayers. The evidence on this issue is inconclusive.

[*387] *With regard to ratepayer costs. Transphase's reliance on per kW cost comparisons as evidence of utility inefficiencies is misleading, as SDG&E points out, because utilities invest in DSM for both energy and capacity cost savings.[21] For that reason, we require utilities to compare DSM program cost-effectiveness using the avoided costs of both energy and capacity, rather than relying on costs per kW or per kWh comparisons.[22] Moreover, Transphase's assertions that third parties can provide ratepayers with commensurate energy savings, at lower total costs, presumes an outcome of DSM bidding that we have yet to test. Transphase does not even present evidence that third parties have actually bid at lower total costs to perform similar programs in other parts of the country, or have agreed to subcontract with utilities at lower total costs. Based on the evidence in this proceeding, we cannot conclude, as Transphase does, that utilities are using their access to DSM program funds in an anticompetitive manner.

We also do not agree with Transphase that the utilities have "conspired" to restrain trade in their development of the proposed bidding pilots. The utilities testified in this proceeding, upon cross-examination by Transphase, that each selections of market sectors were made independently, based on each company's own assessment of what would constitute an appropriate replacement bid, and in response to feedback from Advisory Committee attendees and the assigned ALJ. (TR at 779-781, 982-983, 986-992, 1243-

1244; SDG&E Reply Brief, p.18; ALJ Ruling dated March 11, 1992.)[23]

Even if such anticompetitive behavior were proven, we would not necessarily require that all ratepayer funding for DSM be put out to bid by third parties, as Transphase proposes. This does not mean that we would condone such behavior, but only that we would find another remedy. Transphase apparently believes that anything short of that is in direct violation of Chapter 984. We strongly disagree. Chapter 984 expresses the Legislature's intent that the DSM market develop in a manner that is competitive, and "free from the potential dominance of regulated electrical and gas corporations." It does not specify, however, the method by which we should ensure that outcome. It certainly does not state that we should prefer a regulatory approach that provides ratepayer funding for third-party investments in DSM via a competitive auction process. Rather than dictate the means by which we regulate utility involvement in DSM, the Legislature has generally elected to delegate to this Commission the authority for taking whatever actions are necessary to fulfill our regulatory mandate. (See PU Code § 701.)

In the instance of DSM bidding, however, the Legislature has chosen to provide explicit guidance, a fact that Transphase apparently ignores. By adding § 747(c) to the PU Code in 1990, the Legislature clearly directs us to "test the waters" of DSM bidding on a pilot basis. (See Attachment 1.) While the statute itself does not define the term "pilot projects," we agree with SDG&E that the only reasonable interpretation of § 747 requires that we first test DSM competitive bid auctions on a *pilot or trial scale* before considering larger scale implementation. As we

recently stated in our decision to reduce PG&E's proposed bidding pilot from 50 MW to 20 MW:

> "Once we have had the opportunity to evaluate all of the bidding pilots initiated pursuant to PU Code § 747, we will be in a better position to determine how large the role of DSM competitive bidding should be in delivering energy services. This approach is consistent with PU Code § 747(c), which requires that we first 'assess the feasibility and implications of implementing the tested bidding systems,' before making recommendations on whether DSM bidding systems should be used to fulfill future electric utility resource needs." (D.92-03-03[8], p. 65.)

For similar reasons, we denied Transphase's motion to allow third-party providers of DSM services to bid, along with QFs, for the deferrable generation authorized in D.92-04-045:

> ". . . we prefer to test various forms of DSM bidding on a pilot scale, before allocating a large amount of capacity through any single auction and form of bidding. This
388] approach is *consistent with PU Code § 747(c), which requires that we 'assess the feasibility and implications of implementing the tested bidding system' *before* making recommendations on whether DSM bidding systems should be used to fulfill future electric utility resource needs. We disagree with Transphase that the only "true test" of integrated bidding requires immediate implementation of the integrated bidding pilot(s) at a scale commensurate with supply-side bidding."

(D.92-04-045, pp.38-39.)[24]

Hence, we find no merit to Transphase's arguments that limiting the size or scope of these DSM bidding pilots would violate state and federal antitrust laws. The state-action doctrine clearly applies to our decision to limit the size and

scope of these bidding pilots and to utility actions to carry out pilots which, by definition, limit the access of third parties to ratepayer-funded DSM. As SoCal and others point out, we are acting under direct legislative mandate to implement DSM bidding experiments and that, by definition, these experiments should be small in scale. Moreover, we have been given the explicit authority by the Legislature to regulate these pilots, and are overseeing their development, implementation, and evaluation. (See D.92-03-038 and D.92-02-075, pp. 61-62.) This degree of regulatory oversight goes far beyond the minimum level of supervision found appropriate in prior state action cases.[25]

Our approach to testing DSM bidding is not only consistent with legislative intent, but it is also grounded in sound public policy. A competitive auction process puts California ratepayers in the role of directly financing non-utility investments in DSM resources. Before committing ratepayers to that new role, we must carefully assess the potential benefits of such arrangements, and make sure that those arrangements appropriately allocate risks and rewards among ratepayers, utilities, and third parties. To do otherwise would not serve the public interest.

At the same time, the public interest also requires that we regularly reassess whether and how ratepayers should continue to finance utility involvement in the DSM market. As SDG&E points out, we currently address these types of issues in various utility-specific and generic DSM proceedings. (See SDG&E Opening Brief, p. 7.) Transphase's testimony serves as an important reminder that we must also regularly reassess utility involvement in DSM to ensure that it fosters, rather than impedes, private market developments. Clearly, utility-sponsored DSM programs will need to change in response to the changing realities of the marketplace.

It is therefore our responsibility to ensure that utility programs are designed and implemented in ways that acknowledge and accommodate such changes. For example, a DSM rebate or "give away" program designed to foster competition at the manufacturers' level may at some future time have a dampening effect on retail competition, as that market also develops. Therefore, the nature of a utility's involvement in that market should also change. Rebate levels established at one point in time may also need to be adjusted to optimize the penetration of cost-effective DSM measure. Funds originally earmarked for one type of DSM activity may need to be reallocated to another, based on new information on public receptiveness and changes in economics that increase or decrease program cost-effectiveness.

We have long recognized that the DSM market is dynamic, and that utility programs must evolve as part of a continual learning process.[26] Accordingly, we have given the utilities flexibility to modify Commission-adopted expenditure levels and program designs in order to accommodate market changes. (See Section 6.4.2 below.) Utilities also have flexibility to subcontract with third parties to deliver DSM services, and are expected to do so in ways that maximize program effectiveness and efficiency. Consistent with Chapter 984 and our own stated objectives, we expect utilities to use their program management discretion in ways that foster a competitive market in DSM. The introduction of DSM shareholder incentives does not change our expectations, and those of the Legislature, that regulated utilities will involve themselves in DSM markets in a procompetitive
[*389] manner, and will extricate themselves from market *sectors where their involvement is no longer necessary.

The specific issue of utility interface with private DSM markets can be assessed and monitored in several Commission forums. The potential impact of planned utility DSM activities on competition can most effectively be evaluated

in our general rate case proceedings, where we consider DSM funding requests. In all future funding proceedings, utilities should present testimony on how their proposed DSM programs interface with private market activities and foster competition in DSM markets. This will provide intervenors, such as Transphase, with a specific forum for bringing potential anticompetitive program design problems to our attention. We will use this information in our evaluation of utility DSM funding proposals, in order to ensure that Commission-approved programs foster competition.

Our ratepayer funds are authorized for DSM programs, we rely on the good faith efforts of utility management to use the funding and operational flexibility we have awarded them to the benefit of ratepayers. Moreover, any changes that utilities make to those programs must be consistent with our goal of fostering a competitive private market. Instances where the utility is using its flexibility in a manner inconsistent with our policies can be brought to our attention via our complaint procedures, or by special motion as DRA has recently done in SCE's general rate case proceeding (Application (A.) 90-12-018).[27] We will also initiate generic investigations, when appropriate. However, we agree with SESCO that any actions based on a failure to comply with state or federal antitrust statutes should be heard by the courts, not this Commission.[28]

The issue of utility interface with DSM private markets will also be considered as we reexamine the effectiveness of DSM shareholder incentives, beginning in 1993. In particular, we will examine how shareholder incentives affect utility involvement in the DSM market and how best to structure those incentives, if they are continued, to ensure that the market continues to develop competitively. In addition, our evaluation of the DSM bidding pilots will assess how best to structure the relationship between utilities and third parties in a competitive bidding environment.

While it is important to identify Commission procedures for addressing these issues, we also recognize that litigation and the formal hearing process are resource intensive and time consuming for all involved. Therefore, we encourage parties to also try to resolve their specific concerns about utility DSM program implementation informally. The utility Advisory Committee process was established for this very purpose.[29] In addition to their other advisory activities, these Committees should play a role in alerting utilities to potential conflicts between their program activities and private market development. We therefore direct respondents, via the Advisory Committee clearinghouse, to schedule joint meetings of the SCE, SoCal, SDG&E, and PG&E Advisory Committees to discuss inter-utility issues, including potential conflicts between utility program activities and competitive private market developments. The Advisory Committee clearinghouse administrator should use due diligence in sending notice of these joint Advisory Committee meetings to private DSM suppliers potentially affected by utility involvement in the market, including existing vendors, contractors, and subcontractors eligible to deliver DSM measures and services under contract with utilities. Notice of these joint meetings should also be sent to the service list in this proceeding.

5.2.6.2 *Bid Design and Size*

Before addressing parties' specific proposals on the bid design and size of these pilots, we will review our intended purpose for conducting DSM bidding pilot programs, including PG&E's pilot approved in D.92-03-038 and the upcoming integrated bidding pilots. That purpose is best summarized by our discussion in D.92-03-038:

> "In our view, the primary purpose of the bidding programs is to test various forms of competition on a pilot scale before committing to any single form. At this point in time, we do not know what the future

competitive market in DSM will look like, or what exact

* * *

[*434] *FOOTNOTES

* * *

[8]Under SDG&E's program, the savings build up to these amounts cumulatively, whereas SCE expects to achieve approximately 30 gWh from its small offices solicitation in the first year, and maintain the savings over a seven-year period. (See Table 2 and Exh. 108, Table 2-B.)

* * *

[*435] *[17]*Parker v. Brown* (1943) 317 US 341; *Cantor v. Detroit Edison Company* (1975) 428 US 579; *California Retail Dealers Ass'n v. Midcal Aluminum, Inc.* (1980) 445 US 97; *Southern Motor Carriers Rate Conference v. United States* (1985) 471 US 48; *Goldfarb v. Virginia State Bar* 421 US 773 (1975).

[18]The full text of Chapter 984 is appended to this order (see Attachment 3).

[19]The Commission's interest in having utilities explore all cost-effective DSM was first expressed in 1975, in a PG&E general rate case proceeding. (D.84902, 78 CPUC 746 (1975).) See also D.91107, 2 CPUC 2d 706 (1979). Also in 1975, the Legislature added §§ 2781-2788 to the PU Code, which directed the Commission to adopt requirements for utility home insulation assistance and financing programs. (Stats. 1975, Ch. 1201.) Ratepayer funding for those programs was authorized in D.87242, (81 CPUC 557 (1977) and D.88661, (83 CPUC 503 (1978)). Ongoing utility activities to promote cost-effective DSM programs have been authorized in subsequent utility general rate cases. See, e.g., D.84-12-068, 16 CPUC 2d 721, 820-840.

[20]See DSM OIR/OII, pp. 4, 8-9, 40-42.

[21]Transphase's per kW cost calculation for SCE is also misleading, for two reasons. First, the calculation ignores a correction made by SCE witness Hassan, which would adjust the per kW figure down to approximately $539/kW. Second, Transphase includes incentive and administrative costs attributable to projects signed prior to 1991 in the

numerator, while dividing only by the 1991 sign-ups in the denominator. (TR at 1331-1335.)

[22]See Section 6.1.2.1 below for a discussion of the cost-effectiveness tests used to evaluate DSM programs.

[23]However, we agree with Transphase that neither the Noerr-Pennington doctrine nor Section 17024 of the California Business & Professions Code apply here, as SDG&E asserts. (See SDG&E Opening Brief pp. 8-10; Transphase Reply Brief, pp. 16-18.) The Noerr-Pennington doctrine basically says that a competitor can petition its government for a statutory advantage in the marketplace. *Blank v. Kirwin* (1985) 39 Cal.3d 311; *Eastern Railroad Presidents Conf. v. Noerr Motor Freight Inc.* (1961) 365 US 127; *United Mine Workers v. Pennington* (1965) 381 US 657; *California Motor Transport Co. v. Trucking Unlimited* (1972) 404 US 508. However, Transphase has not alleged that the utilities' petitions to the Commission or Legislature violate antitrust laws. Nor has Transphase claimed that SDG&E has violated the Unfair Practices Act, to which Section 17024 of the California Business & Professions Code applies.

[24]We also denied Transphase's motion for rehearing of our decision on this matter. See D.92-07-027.

[25]See *Patrick v. Burget* (1988) 486 US 94; *Washington State Electrical Contractors Ass'n, Inc. v. Forrest* (9th Cir 1988) 839 F.2d 547; *Turf Paradise, Inc. v. Arizona Downs* (9th Cir 1982) 670 F.2d 813; *Llewellyn v. Crothers* (9th Cir 1985) 765 F.2d 769; *Bates v. State Bar of Arizona* (1977) 433 US 362.

[26]See D.91107 2 CPUC 2d 706, 707 (1979).

[27]DRA's Motion, dated April 3, 1992, relates to an investigation into the potential misuse of ratepayer funds by SCE employees and subcontractors providing services to SCE for their DSM-related programs.

[28]In its comments on the ALJ proposed decision, SoCal argues that this Commission, not the courts, should have primary jurisdiction over disputes concerning antitrust violations. We disagree. While this Commission clearly has an obligation to consider the antitrust implications of applications brought before it, this Commission does not have jurisdiction to determine violations of antitrust laws. This distinction was clearly articulated by the Supreme Court in *Northern California Power Agency v. Public Utilities Commission* when it explained: "This is not to suggest, however, that regulatory agencies have jurisdiction to determine violations of the antitrust laws." [(1971) 5 Cal.3d, 377, quoting from *Northern Natural Gas Co. v. Federal Power Com'n* (1968) 399 F.2d

953]. The Supreme Court goes on to explain that the Commission's consideration of antitrust problems is "for purposes quite different from those of the courts." (Id. at p. 378.)

[29]Pursuant to settlement agreements approved by the Commission in D.90-08-068, each utility has formed Advisory Committees to assist in the implementation of its DSM programs. The Advisory Committees provide an informal forum for parties to review progress made by the utility in implementing approved DSM activities, and to work with the utility on proposed changes. Advisory Committee clearing-house procedures were developed to improve the coordination of Committee activities. See *Joint Clearinghouse Report* dated May 19, 1992.

* * *

Re Biennial Resource Plan Update

Decision 92-04-045
I.89-07-004, Applications 91-02-092 et al.

California Public Utilities Commission
April 22, 1992

INTERIM opinion reviewing long-term electric resource plans and addressing generic issues related to utility purchases of electricity from qualifying cogeneration and small power production facilities (QFs).

Commission finds that the respondent electric utilities have a current need for additional electric generation capacity. It identities resources that could meet those needs, consistent with its criteria for environmentally sensitive least-cost planning, and directs the utilities to solicit bids by QFs to defer or avoid those resources pursuant to the Standard Offer 4 auction process.

The decision reaffirms the commission's commitment to recognize all significant costs, including environmental externalities (to reflect residual air emissions) in choosing the long-term mix of resources to meet the state's electric generation requirements, and to provide price signals needed to help energy suppliers plan for the participate in the state's electricity markets.

For each electric utility respondent, the commission designates certain deferrable generation resources, against whose costs and benefits QFs would bid. Requests for findings of nondeferrability regarding specific resources are also considered. Long-run marginal costs and biddable capacity are established for each electric utility respondent, consistent with economic and operational need tests. The amount of capacity (and benchmark prices) to be offered

for possible "deferral" through QF bidding are specified; however, the decision does not require that only QFs fill such capacity.

Commission also decides not to mandate a specific utility resource plan, or to award permits for a specific project.

* * *

[*227] *issues raised by GRA/IEP and DRA, and the issues raised by DRA witness Schultz about coordination between different CPUC proceedings, in our consolidated DSM rulemaking and investigation. (R.91-08-003 and I.91-08-002.)

We also agree with GRA/IEP witness House that, given the large amount of DSM in current utility resource plans, it is legitimate to consider the uncertainty of DSM forecasts, especially if evidence shows that the confidence levels for these forecasts are lower than the other key planning assumptions. Conversely, uncertainty analysis could include CEERT's suggestion to create a scenario utilizing DSM and renewable resources exclusively.

3.2.3 *DSM Bidding Pilots*

In a separate DSM Rulemaking/Investigation (R.91-08-003/I.91-08-002), we are testing various forms of DSM bidding pursuant to PU Code § 747 and our recently adopted rules governing DSM.[33] PU Code § 747 requires that one or more energy utilities implement pilot programs to test: (1) the ability of DSM bidding to deliver benefits to utility customers, separate from any generation resource bidding system; (2) the feasibility of an integrated bidding system that includes both generation resources and DSM programs; and (3) a program of competitive DSM bidding auctions for gas utilities. We have recently approved a DSM-only bidding pilot for PG&E, and additional pilots will be submitted for our consideration this year. (See D.92-03-028.)

On February 24, 1992, Transphase Systems, Inc. (Transphase) filed motions to intervene in the Update and to consolidate integrated bidding with this proceeding. Transphase request that third-party providers of DSM services be allowed to bid, along with QFs, for the deferrable generation authorized today. To this end, Transphase recommends that we augment the solicitation packages for final Standard Offer 4 to incorporate integrated bidding procedures. In Transphase's view, this proposed consolidation would eliminate the need for "redundant" integrated bidding pilot(s) and prevent relitigation in a DSM proceeding of all the generation/supply-side issues currently being resolved in this update.

PG&E, SDG&E, DRA, and GRA/IEP filed replies to the motion and were unanimous in their opposition.[34] They stated that including a DSM sonication in this Update would be premature and would unduly complicate and delay the bidding.[35]

We deny Transphase's motion to consolidate. First, contrary to Transphase's assertions, an integrated bidding pilot is easily accommodated within the overall level of resource additions adopted in today's order. This is no basis for Transphase's apparent assumption that, unless the integrated bidding pilot "counts against" QF-deferrable generation, the entire resource plan could be subject to relitigation. As illustrated in Figure 7 above, a relatively small portion of total resource need will be subject to QF bidding over the 1992-1999 period (*i.e.*, less than 1500 MW or 15%). An integrated bidding pilot (or pilots) could easily be summed within the remaining thousands of MWs of need, *e.g.*, within the forecast of uncommitted DSM.

Second, we prefer to test various forms of DSM bidding on a pilot scale, before allocating a large amount of capacity through any single auction and form of bidding. This approach is consistent with PU Code § 747(c), which requires

that we "assess the feasibility and implications of implementing the tested bidding systems" before making recommendations on whether DSM bidding systems should be used to fulfill future electric utility resource needs. We disagree with Transphase that the only "true test" of integrated bidding requires immediate implementation of the integrated bidding pilot(s) at a scale commensurate with supply-side bidding.[36]

Consideration if integrated bidding pilot(s) will remain in our DSM Rulemaking/Investigation. We leave the scheduling of the various phases of that Rulemaking/Investigation to the ALI assigned to that proceeding.

3.3. *How Transmission Access Affects This Decision*

[17] Growth in alternative generation

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[*270] *FOOTNOTES

* * *

[*272] *[33]See D.92-02-075 in R.91-98-003/I.91-08-002.

[34]GRA/IEP's reply was timely served but filed a day late. For good cause,, GRA/IEP's request for leave to file late is granted.

[35]SDG&E also notes that Transphase's petition to intervene is deficient under Rule 54 of the Commission's Rules of Practice and Procedure. We agree with SDG&E that Transphase "Raises new issues . . . at the eleventh hour." We therefore deny the petition without prejudice. Although this ruling technically moots the motion to consolidate, we explain in the body of the opinion why such consolidation would not be appropriate.

[36]We also disagree with Transphase's assertion that the proposed consolidation could be accomplished without any disruption in the schedule for this proceeding or the DSM Rulemaking/Investigation. Transphase's assumption that proposals for integrated bidding protocols can be developed, adopted, and implemented without extending the auction schedule is unrealistic.

Decisions 92-07-027 July 1, 1992

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Order Instituting Investigation on the Commission's own motion to implement the Biennial Resource Plan Update following the California Energy Commission's Seventh Electricity Report.	I.89-07-004 (Filed July 6, 1989)
And Related Matters.	A.91-02-092 (Filed February 25, 1991) A.91-07-004 (Filed July 1, 1991) A.91-08-028 (Filed August 16, 1991)

ORDER DENYING REHEARING OF DECISION 92-04-045

Transphase Systems, Inc. (Transphase), has filed an application for rehearing of Decision 92-04-045, an interim opinion in the Biennial Resource Plan Update (BRPU) proceeding, regarding bidding for the new generation resources plan phase of that proceeding. In Decision 92-04-045 we found that Pacific Gas and Electric Company (PG&E), San Diego Gas & Electric Company (SDG&E) and Southern California Edison Company (Edison) all have current need of new or additional electric generation. We directed those utilities to solicit bids from qualifying facili-

ties (QFs) to defer or avoid resources identified by the Commission that could meet those generation needs as set forth in our Standard Offer 4 auction process.[1] The decision establishes the respective utilities' long-run marginal costs, as well as the biddable capacity consistent with the economic and operational need tests established in the proceeding which *considered the California Energy Commission's 1990 Electricity Report. (See D.92-04-045 at 14-15.)

[*2]

Transphase is not a party to this proceeding but is a party to another ongoing proceeding, the Demand-Side Management (DSM) Rulemaking/Investigation (OIR/OII) (R.91-08-003, I.91-08-002, I.91-07-004). Transphase sought to intervene in the BRPU proceeding and filed a motion in the DSM OIR/OII proceeding to have the two proceedings consolidated for consideration of the issue of integrated bidding pilot(s). However, we denied Transphase's motion because an integrated bidding pilot can be accommodated within the proceeding and, in any event, we determined it is preferable to test various forms of DSM bidding on a pilot scale before we allocate a large amount of capacity through any single auction and form of bidding. (See D.92-04-045 at 38.) As we stated in the decision, we will consider integrated bidding pilot(s) in our DSM OIR/OII.

In addition to renewing its motion to intervene and consolidate, Transphase, in its application for rehearing of Decision 92-04-045, has also challenged our ability to meet the January 1, 1993 deadline for reporting to the Legislature, pursuant to Public Utilities Code § 747[2], on the feasibility of integrated bidding pilot(s). § 747 provides, in

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[1]See *re Pacific Gas and Electric Company* (1986) 21 Cal.P.U.C.2d 340, 372-373 (Decision 86-07-004).

[2]All statutory references are to the Public Utilities Code unless otherwise indicated.

part, that we must require one or more of the electric utilities to test, at the earliest practicable time, the feasibility of an integrated bidding system that includes both generation resources and demand side programs. In addition, on or before January 1, 1993, we are to report the results of pilot bidding projects to the Legislature. (Pub. Util. Code (747(c).)

However, pursuant to the June 15, 1992 letter from the author of section 747, Senator Herschel Rosenthal, to Com-
[*3] mission *President Daniel Wm. Fessler, the Commission is to file a status report with the Legislature on or before January 1, 1993, concerning pilot bidding projects. A final report on the project is not due until a later date. Senator Rosenthal's letter confirms that this schedule will satisfy the reporting requirement. We are making every effort to test integrated bidding pilot(s); however, we believe the most efficient solution is to first review the alternatives for an integrated bid. Accordingly, we have ordered the Bidding Advisory Group to develop an options paper on the subject, due on or before January 1, 1993. Transphase has failed to rebut our conclusion that the development of an options paper is the most expedient and efficient use of every party's resources in this proceeding, as well as our own.

No further discussion is required of the applicant's allegations of error. Accordingly, upon reviewing each and every allegation of error raised by applicant, we conclude that sufficient grounds for rehearing of Decision 92-04-045 have not been shown.

THEREFORE, IT IS ORDERED:

That the application for rehearing of Decision 92-04-045 filed by Transphase Systems, Inc., is denied.

This order is effective today.

Dated July 1, 1992, at San Francisco, California.

DANIEL WM. FESSLER
President
JOHN B. OHANIAN
PATRICIA M. ECKERT
NORMAN D. SHUMWAY
Commissioners

* * *

ALJ/MEG/mds
Decision 92-02-041 February 17, 1993

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Order Instituting rulemaking on the Commission's own motion to implement establish rules and procedures governing utility demand-side management.	R.91-08-003 (Filed August 7, 1991)
Order Instituting Investigation on the Commission's own motion to establish procedures governing demand-side management and the competitive procurement thereof.	A.91-08-002 (Filed August 7, 1991)

(See Attachment 3 for List of Appearances.)

INTERIM OPINION
SDG&E AND SCE'S DSM-ONLY BIDDING PILOTS COMPLIANCE FILINGS

* * *

[*3]

*II. Background

In D:92-09-080, we approved DSM-only bidding pilots for SDG&E, SCE and SoCal consistent with the mandate of Public Utilities (PU) Code § 747. SCE and SDG&E filed revised requests for proposals (RFPs) and related

solicitation materials, in compliance with D.92-09-080, on November 16 and 17, respectively.[2] By ruling dated December 3, 1992, the assigned Administrative Law Judge (ALJ) requested additional information and clarification of the compliance material. SCE and SDG&E filed additional information on December 11, 1992. Comments on SCE's and SDG&E's compliance filings were submitted by the Natural Resources Defense Council (NRDC), Transphase Systems Inc. (Transphase) and SESCO Inc. (SESCO).[3]

In D.92-09-080, the Commission directed SDG&E, So-Cal and SCE to use a definition of Total Resource Costs (TRC) in evaluating bid proposals that was different from the definition developed in the *Standard Practice Manual (SPM)*. The *SPM*, which presents a cost-benefit methodology for the evaluation of DSM programs, is the product of informal workshops among the staffs of this Commission and the California Energy Commission (CEC), the major energy utilities and interested parties.[4]

Under the *SPM* definitions, the TRC test treats all rebate or incentive payments to customers as "transfers," even if the rebate exceeds the cost of the measure or equipment installed. The Commission questioned this treatment in D.91-12-076 and D.92-09-090:

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[2]SDG&E's request for a one-day extension of time to file this material was approved by Administrative Law Judge ruling dated December 3, 1992.

[3]SESCO filed its comments three days late, due to unexpected travel and illness of its attorney. Since there was no schedule for parties to file responsive comments, we find that no party is prejudiced by SESCO's delay in filing. We grant SESCO's request for a three-day extension.

[4]The most recent (December 1987) version of this document is entitled: *Standard Practice Manual: Economic Analysis of Demand-Side Management Programs.*

[*6] * in D.92-09-080, how to consider utility administrative costs in bid evaluation and how projected savings should be measured and evaluated. We address these and other compliance issues in the following sections.

A. Avoided Costs

In D.92-09-080, we directed SDG&E and SCE to present revised avoided cost assumptions in their compliance filings, based on the outcome of our Biennial Resource Plan Update (Update) proceeding (D.92-04-045 in Investigation (I.) 89-07-004). We directed the utilities to use their preferred methods for translating the findings of D.92-04-045 into avoided cost updates, with the understanding that formal consideration of the appropriate methods was still underway as part of the DSM/Update consistency phase of this proceeding. (See D.92-09-080, mimeo., p. 83.)[7]

Transphase objects to the use of SCE's revised avoided costs, arguing that they are significantly lower than (1) the identified deferrable resource costs SCE will use for its upcoming supply-side solicitation and (2) the avoided costs SCE used in the 1992 GRC to evaluate in-house DSM programs. SDG&E also notes that the avoided costs developed from the Update decision, using SDG&E's preferred method for translating Update findings into avoided costs, produces avoided costs that are significantly different from the ones used in its test year 1993 GRC. In general, SDG&E's revised avoided costs are lower for energy and higher for capacity than the GRC figures. SDG&E recommends that it use avoided cost numbers from its recent

[7]At the time that D.92-09-080 was issued, workshops on DSM/Update consistency issues had just been completed. CACD issued its workshop report on November 2, 1992. We are currently reviewing a series of comments and replies on appropriate methods for translating Update results into avoided costs, for use in evaluating DSM programs.

GRC for purposes of this bidding pilot, rather than avoided costs that rely on the results of D.92-04-045.

We had hoped that the workshop process in our DSM/Update consistency phase would yield general consensus on the appropriate *methods for translating Update [*7] results into avoided costs for evaluating DSM programs. Based on the comments received in that phase, however, it is clear that the resolution of methodological issues will take longer than anticipated. Parties have expressed widely divergent views on the appropriateness of proposed methods for developing long-run avoided energy and capacity costs for DSM cost-effectiveness testing. For example, some parties propose that the costs associated with identified deferrable supply-side resources be used directly to establish avoided costs (as Transphase suggests), while others (.e.g., SCE) argue that an incremental/decremental calculation be made using a resource plan that includes all identified deferrable resources. The conceptual soundness of these and other proposals still needs to be explored.[8]

Until we are able to sort through the methodological issues raised in the DSM/Update consistency phase, we are unable to fully achieve our goal of improving consistency in the valuation of resource benefits for both supply- and demand-side investments. (See Rules 7 and 8 of D.92-02-075.) However, our resolution of DSM/Update consistency issues cannot practicably be achieved for SDG&E's and SCE's bidding pilots without significantly delaying the solicitation schedule. Rather than hold up the pilot programs, we will direct SDG&E and SCE to evaluate bid proposals using the avoided costs they propose to use to evaluate their own DSM programs in 1993.

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[8]See *Demand-Side Management Workshop Report: DSM/Update Consistency issues*, CACD, November 2, 1992 and subsequent comments on consistency issues filed on December 1, 1992 in this proceeding.

Accordingly, SDG&E should use its recent GRC assumptions, i.e., the avoided costs underlying its March 1992 revised report on DSM filed in A.91-11-024. For SCE, however, we have already determined that the most recent GRC assumptions (for test year 1992) require updating.[9]

[*8] *In response to Commission directives, and after extensive input from interested parties, SCE recently updated its GRC forecasts of DSM program savings and earnings projections for 1993 (See Advice Letter No. 978-E filed December 18, 1992). No protests have been filed. In evaluating pilot bid proposals, SCE should utilize the avoided costs underlying these recent projections.

Although this approach does not achieve our ultimate goal for DSM/Update consistency, it does ensure that SCE and SDG&E will be valuing the resource benefits of bidders' proposals consistent with the most recent valuation of their own in-house DSM program benefits. It is also consistent with the approach we adopted for PG&E's pilot bidding program. (See D.92-03-038 and D.92-09-072.)

D. Minimum Standard Equipment

In D.92-09-080, we required SDG&E, Socal and SCE to use minimum standards equipment, not existing equipment, as the baseline reference for calculating energy savings. (D.92-09-080, COL 59.) According to SDG&E, strict interpretation of COL 59 would require the use of minimum standards equipment for "pre-failure" applications, i.e., for programs targeted at early equipment replacement. SDG&E questions the appropriateness of applying a strict interpretation for these applications, based on SDG&E's experience that pre-failure equipment is often operating below current

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[9]See D.91-12-076, mimeo., pp. 161-162; Ordering Paragraph 40; Resolution E-3288, Paragraph No. 7 at p. 4.

minimum standards. For similar reasons, NRDC argues that "real world" data, rather than minimum standards equipment, should be used as the basis for savings estimates.

SESCO argues that SDG&E has misinterpreted COL 59 by applying the rule to residential retrofit applications. According to SESCO, the minimum equipment standards rule should not apply to residential retrofit applications because (1) there are no legal standards requiring that any existing equipment be removed or replaced and (2) weatherization materials are not energy-using equipment. More generally, SESCO agrees with SDG&E that the minimum standards equipment rule should not strictly apply to retrofit applications. In SESCO's view, a method is needed to account for the expected savings during the time that the old unit would have

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[*14] *TRCs. Transphase notes that it is not clear from SCE's submittal whether the bidder's TRC calculation will be compared to SCE's composite TRC calculation or to the specific DSM program measures proposed by each bidder.[15] Based on the direction given in D.92-09-080, we agree with Transphase that the latter should apply for bidders that focus on specific measures. SCE should make this clarification in its final RFP. Also, as Transphase points out, SCE should include TRC values for its thermal energy storage program for retrofits, and other load management measures. Moreover, SCE should recalculate and publish its composite TRC without differentiating among pay-back categories.

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[15]SESCO is correct that bidders are compared against each other in the cost-effectiveness ranking and scoring process. (SESCO's comments, p. 13.) However, to meet the minimum threshold requirements, the bidder's project must be compared to the utility's DSM program, i.e., its TRC must be greater than the TRC for the utility program (or program component) being replaced.

For all three utilities conducting replacement bidding pilots, the values and sources of all assumptions used to calculate utility program TRCs, including any inflation/deflation factors, should be presented as a separate appendix in the solicitation materials. SDG&E, SCE, and SoCal should file this appendix as part of their pleadings in all 1993-1996 DSM funding or forecasting activities at this Commission. The burden will be on the utilities to justify deviations from these assumptions for the purpose of funding their in-house programs, or for forecasting program savings, costs and earnings.

Transphase also argues that SCE's TRC values should not include new construction projects, since these types of projects are not applicable under the approved replacement bidding pilot. We agree with Transphase's observation. If the TRC ratios published in SCE's December 11, 1992 filing include new construction projects, they should be modified accordingly.

D. Net-to-Gross Ratio

The net-to-gross (NTG) ratio is designed to discount the value of estimated energy savings to account for certain factors,

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[*16] *assistance in marketing efforts, billing information, publicity) and general program overhead costs, such as those related to bid solicitation or contract negotiations. We determined that bidders would either reimburse the utility for selected administrative services, or perform those functions themselves. PG&E was directed to provide bidders with a menu of administrative functions and their approximate cost. As in the case of solicitations/negotiations with qualifying facilities or other utilities, the more general administrative costs were to be borne by ratepayers, not individual bidders. Indeed, for all four bidding pilots, we have approved

funding for general utility administrative costs over and above the estimated costs of payments to winning bidders.

1. Consideration In Bid Evaluation

In its comments, Transphase poses the question: "Is it fair to assume that if the bidder does not take the opportunity to use one of the [administrative] functions offered by the utilities ... that the utility's administrative cost is zero?" Based on the directives of D.92-03-038, as reaffirmed in D.92-09-080, the answer is yes. The utility should not undertake any project-specific administrative functions not selected by the bidder, and (as discussed above) general administrative costs associated with the program will be paid for by ratepayers. Nor should any general administrative costs (or "routine" costs as SDG&E terms them) be allocated to individual bidders for evaluation purposes, either in the initial cost-effectiveness scoring or in subsequent calculations of program cost-effectiveness security requirements.[17]

Moreover, if the bidder does take the opportunity to use the utility's reimbursable services, the cost of those services
[*17] *should not be included as a separate line item in TRC calculations. These costs are internalized in the bid price, which is included in the calculation of both TRC and Utility Cost (UC) tests. As Transphase points out, to separately include these costs in the calculations would "double count"

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[17]SDG&E includes the costs of verifying reported energy savings in its definition of "routine" administrative costs. At the same time, in a different phase of this proceeding, SDG&E and others recommend that the Commission ignore (for the near term) the measurement and verification costs associated with utility-sponsored programs. In Section F. below,we address the treatment of measurement and verification costs in the evaluation of replacement bidding pilots.

bidders' reimbursable administrative costs.[18] SCE and SDG&E should motify their bid solicitation material to comply with these directives.

2. Menu of Administrative Functions/Access to Customer-Specific Information

SESCO raises objections to specific elements of SDG&E's published administrative functions and costs. Specifically, SESCO argues that SDG&E's provided services lack a quote for simply providing bidders with computer tapes on residential billing records. Moreover, SESCO objects to the requirement that customer billing histories only be available after customer contact and upon written customer consent. Finally, SESCO objects to SDG&E's language stating that the administrative costs are preliminary and may be subject to variation.

The California Supreme Court, in *People v. Blair* ((1979) 25 Cal 3d 640, 653-659) found that a utility customer in California has a reasonable expectation that the records maintained by the utility will not be provided to a third party without legal process. In the past, we have restricted the release of customer billing and credit records in situations where the activities of the third party are clearly unrelated to utility business.[19] However, we have permitted the release of this information in situations where a third party is working for the utility in the capacity of a

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[18]In response to the ALJ's inquiry about this same issue, SCE subsequently deleted "bidder administrative costs" from its calculation of TRC. However, both SCE and SDG&E continue to include "utility administrative costs" in their calculation of TRC and UC tests. As discussed above, these terms should be eliminated from the calculation, as PG&E has done.

[19]See D.8859 (83 CPUC 559), D.92860 (5 CPUC2d 745) and D.92-03-0311, mimeo.

* * *

[*22] *1992 RFPs, page 8 and SCE's December 11, 1992 response to ALJ questions pp. 5-6.)

Transphase objects to SCE's approach, arguing that bidders, not the utility, should be responsible for their own M&V activities and should include the cost of those efforts in the bid price. We agree. Our intent in D.92-09-080 was to have each bidder propose, and the utility review and negotiate, an ex post M&V plan that the *bidder* implements.[21] This does not preclude the bidder and SCE from mutually agreeing to make some exceptions to this arrangement. Nor does it preclude SCE from conducting supplemental studies or independent verifications, as required to assure compliance with our adopted ex post measurement protocols. Nonetheless, it does mean that winning bidders must be prepared to conduct ex post M&V activities, at their own cost. The utility's role in these activities should be to augment the bidders' ex post M&V plan, as needed, to meet the adopted ex post measurement requirements for earnings recovery or resource planning purposes. SCE should modify its solicitation materials (in particular Appendix F) to comply with these directives.

SESCO raises a concern about the source of funding for SDG&E's independent measurement and evaluation activities. In D.92-09-080, we authorized $158,090 in 1993, $145,884 in 1994 and $71,959 in 1995 (in 1993 $) for these types of activities. Similarly, we authorized $108,000 per year (in 1993 $) for SoCal's supplemental M&V activities.

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[21]We believe that this intent is clear from reading the text of that order and D.92-03-038. However, in order to remove any ambiguity, we will modify COL 58 of D.92-09-080 to read: "All bidders should be required to propose *and conduct* ex post measurement and verification plans, and all payments to winning bidders should be based on ex post measurements of savings." (Additions underlined.)

SCE was directed to redirect the M&V funding authorized in its test year 1992 general rate case to pilot-related M&V activities. (See D.92-09-080, mimeo., pp. 93-96.) PG&E was authorized M&V funds in its recent general rate case. (See Exhibit 214 in A.91-11-036, which details the joint recommendations

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[*29] *that a compromise is in order. SDG&E should raise the thresholds to 4,000, 8,000 and 15,000 equivalent kWh, respectively. In addition, bidders should be required to install at least two different measures in order to qualify for the ten-point bonuses associated with lifetime energy savings. SDG&E should modify its comprehensiveness attribute accordingly.

J. Other Compliance Issues

In response to the assigned ALJ's December 3, 1992 ruling, SCE made several modifications to its solicitation materials. In particular, in compliance with the directives of D.92-09-080, SCE clarified that:

- The role of winning bidders in the industrial and large commercial sector pilot is to both design and implement an SCE-sponsored program (as opposed to implement an SCE-designed program);
- More than one winning bidder may be selected in each market region for the industrial and large commercial solicitation;
- Bidder payments will be reduced commensurately, if actual customer costs exceed the estimates provided in the response package; and
- Bidder administrative costs are not included as a separate line item in the calculation of total resource costs.

In addition, SCE added clarifying instructions to the calculation of bidders' cost-effectiveness scores, and provided measure-specific TRCs for its own programs. (See SCE's December 11, 1992 filing, Attachments B and C.) SDG&E also corrected some minor clerical errors. (See Attachments 4, 5, 6(a) and 6(b) of SDG&E's December 11, 1992 filing.) SCE and SDG&E should incorporate these clarifications and modifications in their final solicitation materials, except as otherwise modified by today's order. We also find the minor modifications proposed in SDG&E's January 29, 1993 filing to be reasonable.

SESCO and Transphase request additional language modifications to the utilities bid price calculations, the
[*30] duration *of avoided cost streams and program implementation schedule.[24] We note that the language referenced by SESCO and Transphase was not the subject of our compliance orders in D.92-09-080, and remains unaltered from the utilities' proposed solicitation materials. Therefore, SESCO's and Transphase's proposed modifications in these areas go beyond the scope of this compliance phase; instead, SESCO and Transphase should have raised their concerns during evidentiary hearings on the pilot programs. With regard to SESCO's concern about SDG&E's implementation schedule, we expect that proponents of projects requiring longer leadtimes will be able to negotiate appropriate modifications to the sample contract. (See D.92-09-080, mimeo., pp. 90-92; p. 100, footnote 69.)

K. Utility Compliance Filings

In compliance with today's decision, we direct SCE and SDG&E to revise their RFPs, Response Packages and Sample Contracts, and to file those revisions within 20 days

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[24]See Transphase's comments, pp. 4-5; SESCO's comments, pp. 8-9, 12. SESCO also proposes minor language modifications to pp. 1-13 and 1-24 of SDG&E's RFP (SESCO's comments, p. 15.)

from the effective date of this order. This filing should clearly indicate what deletions/additions were made to the text or tables of the solicitation materials, and include a separate cross-reference between those modifications and the directives in today's decision. Copies should be served on all parties to this proceeding, with overnight service to DRA, SESCO, Transphase, NRDC, CACD, and the assigned ALJ.

In the interest of proceeding as expeditiously as possible with the issuance of RFPs, we will address any remaining compliance issues as follows: Shortly after the revised solicitation material is filed, the assigned ALJ will conduct a compliance conference. At this conference, interested parties will have an opportunity to identify areas where they believe the utilities' filings are not in compliance with today's order. SCE and SDG&E will have the opportunity at the conference to respond to any identified

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[*33] *would require that program proponents provide an analysis of market transformation benefits as a basis for accepting a program that otherwise fails the UC test. Second, CMA recommends that any significant efforts to force technology or otherwise transform the market be made as joint efforts by all the CPUC-regulated utilities.

In its opening comments, SoCal opposes the dual-test approach put forth by DRA and others. In SoCal's view, this approach would favor programs sponsored by combined gas and electric utilities over programs sponsored by single service utilities. SoCal contends that if and when a program offered by a single fuel utility has benefits (i.e., load reductions) for both electric and gas, only the benefits from its "own" fuel is included in the UC test. SoCal bases this interpretation on the *SPM* directives for calculating UC test benefits for fuel substitution programs. (See SoCal's January 6, 1993 reply comments, p. 3.) For this reason, SoCal

prefers that the bidding definition of the TRC test put forth in D.92-09-080, rather than the dual test, be applied to utility-sponsored DSM. In its reply comments, DRA argues that SoCal has misinterpreted the *SPM*.

NRDC did not comment on the issue of whether to extend the bidding TRC definition to the evaluation of utility-sponsored programs. However, in its comments on SDG&E's compliance filings, NRDC recommends that the bidding TRC definition be rescinded for the bid pilots. In NRDC's view, including the cost of rebates in the TRC formula would "unfairly constrain the cost-effectiveness of SDG&E's 1993 High Efficiency Refrigerator Program." As discussed above, NRDC believes that market transformation programs should not be evaluated using the modified TRC test, particularly without accounting for positive benefits of market transformation or free driver effects.

B. Discussion

As DRA, Barakat and others point out, it was our concern over excessive rebates to customers and the impact of DSM bids on revenue requirements that prompted our modification of the TRC test for evaluating pilot bid proposals. As we acknowledged in

* * *

Decision 93-06-040 June 3, 1993

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the Commission's own motion to establish rules and procedures governing utility demand-side management.

Order Instituting Investigation on the Commission's own motion to establish procedures governing demand-side management and the competitive procurement thereof.

R.91-08-003
(Filed August 7, 1991)
I.91-08-002
(Filed August 7, 1991)

(See Attachment 6 for List of Appearances.)

INTERIM OPINION ON INTEGRATED BIDDING PILOT PROGRAMS: THRESHOLD ISSUES

* * *

[*2] *INTERIM OPINION ON INTEGRATED BIDDING PILOT PROGRAMS: THRESHOLD ISSUES

I.

Summary

By this order, we find that Public Utilities (PU) Code § 747 requires one or more electric utilities to solicit megawatts under an integrated bidding pilot program, where supply-and demand-side bidders compete to fill a common block of resource needs. We give parties additional guidance on the appropriate size, timing, and forum for the integrated bidding pilot, and direct the assigned Administrative Law

Judge (ALJ) to establish a procedural schedule for pilot implementation.[22]

II.

Background

In August, 1990, the Legislature passed Senate Bill (SB) 539 which added § 746 and § 747 to the PU Code. The bill was enacted as Chapter 1369 of the 1990 Statutes of California. In brief, PU Code § 746 requires the Commission to implement a pilot program of incentives to encourage utility pursuit of energy efficiency programs. PU Code § 747 requires that one or more energy utilities implement pilot projects to test: (1) the ability of demand-side management (DSM) bidding to deliver benefits to utility customers, separate from any generation resource bidding system; (2) the feasibility of an integrated bidding system that includes both generation resources and DSM programs; and (3) a program of competitive DSM bidding auctions for gas
[*3] utilities. The full text *of Chapter 1369 (Stats. 1990) is presented in Appendix 1. What follows is a description of the steps the Commission has taken to implement the requirements of PU Code § 747.

A. Commission Directions on DSM Pilot Bidding

On August 7, 1991, the Commission issued an Order Instituting Rulemaking and companion Investigation to establish rules and procedures governing DSM activities (DSM OIR/OII). One of the procedures discussed in the August 7 rulemaking was the competitive procurement of DSM services, referred to generally as "DSM pilot bidding." The Commission directed utilities to develop and present pilot programs for consideration, consistent with the

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[22]Appendix 5 explains each technical acronym or abbreviation that appears in this decision.

mandate of PU Code § 747. For this purpose, the Commission endorsed the formation of a Bidding Advisory Group, with representatives from utilities, consumer and environmental groups, energy service companies, and other interested parties. (DSM OIR/OII, mimeo., p. 4.)

By Decision (D.) 92-03-038, the Commission approved a DSM-only pilot bidding program for Pacific Gas and Electric Company (PG&E). Proposals for additional DSM-only bidding pilots were filed by San Diego Gas & Electric Company (SDG&E), Southern California Gas Company (SoCal), and Southern California Edison Company (SCE) on February 28, 1992. On March 5, 1992, a prehearing conference (PHC) was held to establish a schedule for addressing the additional DSM-only bidding pilots, and for scheduling utility filings on integrated bidding pilots. (See ALJ Ruling dated February 14, 1992.) At the PHC, the assigned ALJ requested that PG&E, SDG&E, and SCE (referred to collectively as "the utilities") confer among themselves to select at least one volunteer for an integrated bidding pilot. She also indicated that an Integrated Bidding Advisory Group (Advisory Group) would be asked to develop an options paper for the Commission to "help delineate all the different alternatives for an integrated bidding
[*4] forum, and discuss the pros* and cons, have those written up, talk about different bid evaluation criteria and present that at some interim point before the proposals are filed." (Reporter's Transcript (TR), PHC-2, March 5, 1992, pp. 58-59.)

The utilities responded to the ALJ's request by letter dated March 31, 1992. In that letter, the utilities requested that they be allowed to postpone voluntary commitment to sponsor an integrated bidding pilot until the Advisory Group completed and submitted its options paper later in 1992. The utilities argued that proceeding with the specifics of an integrated pilot would be premature, since many of the

implementation issues associated with supply-side bidding under the Biennial Resource Plan Update process and the DSM-only bidding pilots were unresolved. They also argued that they needed to maintain focus on other DSM-related activities, including the DSM-only bidding pilots and the measurement and evaluation phase of this proceeding.

By ruling dated May 12, 1992, the assigned ALJ agreed with the utilities' suggestion, stating that "the development of an options paper prior to proceeding with specific integrated bid pilots is the most practical use of everyone's time and energy in this multi-phase proceeding.[23] She directed parties to proceed with the development of the options paper, via the Advisory Group, and requested submittal of the paper by January 1, 1993. The submittal was to include the identification of utility volunteers for the integrated bidding pilot. The ruling described the goals of the Advisory Group and expected product, as follows:

> "The group will consider the range of issues that must be considered in developing a pilot integrated bid, and describe the many options, pros and cons, of different bid designs. This approach will help identify the
> [*5] threshold issues* to be addressed either by the group or in hearings or workshops before the utilities develop their integrated pilot proposals.
>
> "... The paper will be used to identify desirable bid components and to determine the threshold issues that must be addressed in evidentiary hearings before the utilities proceed with developing integrated bid RFPs (Request for Proposals) and contract language.
>
> "... The paper will explore bid design issues to help determine the order in which the issues should be

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[23]The Commission endorsed this approach in D.92-07-027 by denying Transphase Systems Inc.'s motion to overrule the ALJ.

addressed in hearings. The options paper is not intended to make recommendations regarding the most appropriate integrated bid design, but must thoroughly examine the implications of following any particular path." (ALJ Ruling dated May 12, 1992, attachment.)

The Advisory Group was formed during the summer of 1992 to scope the project.[24] Members of the Advisory Group included SDG&E, PG&E, SCE, California Energy Commission (CEC), California Department of General Services, Division of Ratepayer Advocates (DRA), and Natural Resources Defense Council (NRDC). The Advisory Group decided to hire Mr. Charles Goldman of Lawrence Berkeley Laboratories to prepare the options paper, with input from the members. The report, entitled *Integrated Resource Bidding Options Paper* (Options Paper) was filed on December 28, 1992. As described in the submittal letter, the Options Paper was not a consensus document; rather it reflected the views of its author, Mr. Goldman. The major issues and findings of the Options Paper are summarized briefly in the following section.

* * *

[*20] *auctions. The pilot should be designed so that we can reach some conclusions regarding this potential.

Moreover, integrated bidding also has the potential to provide important feedback on the utilities' planning assumptions. Whereas the planning process may identify (for example) 200 MW of need for DSM resources, and 300 MW of need for supply-side resources, the integrated bidding process could reveal that the utility should procure more DSM relative to supply-side resources (or vice versa), given the relative price and quantity at which these re-

[24]All parties to this proceeding and the Biennial Resource Planning Update proceeding (Investigation 89-07-004) were invited to participate in the Advisory Group.

sources are offered in the competitive market. Over the longer term, system-wide integrated bidding could even eliminate the need for the extensive resources planning that utilities and Commissions currently undertake. The pilot should be designed so that we can use the results to improve the participating utility's (or utilities') planning assumptions.

With these objectives in mind, we turn to the issue of pilot size. We agree with DESTEC that the pilot solicitation should be large enough to attract a representative sample of both demand- and supply-side least-cost resource options. Otherwise, it will be difficult, if not impossible, to address the objectives outlined above. These objectives would not be fulfilled by a pilot in the 20-45 MW range, as SDG&E proposes. However, we do not believe (as SESCO suggests) that a solicitation equal in size to the QF auctions planned for 1993 (i.e., a total of over 1,200 MW) are appropriate for a pilot.[11] We leave it to the parties to consider options between these two extremes.

Given the number of demand- and supply-side solicitations planned for 1993, we agree with the utilities that a post-1993 implementation date for the pilot is warranted.
[*21] Our goal is to issue *a request for proposals for the pilot sometime in 1994 or early 1995. To the extent feasible, the pilot should be conducted in conjunction with a utility's future supply-side resource acquisition plans.[12] For example, as DRA points out, SDG&E has applied to the Commission for an experimental supply-side "competitive energy procurement" (CEP) program for future supply-side resource

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[11]We also stated this in our response to a motion by Transphase Systems Inc. See D.92-04-045, mimeo., pp. 38-39.

[12]However, as we stated in D.92-04-045, we will not hold up the QF supply-side auctions required by that decision in order to incorporate demand-side bidding. See D.92-04-045, mimeo., pp. 37.39.

acquisitions. (See Application 92-10-017.) If SDG&E plans to issue a request for proposals in 1994 or early 1995 under this program (assuming the CEP is approved by the Commission), it may be appropriate to conduct that solicitation as an integrated pilot.

In any event, we do not intend to delay implementation of PU Code § 747 beyond 1995. If a supply-side solicitation is not contemplated by any of the electric utilities in 1994 or 1995, then we will conduct the integrated bidding pilots independent of those plans. As we stated in D.92-04-045, an integrated bidding pilot can easily be subsumed within current projections of need for additional demand- and supply-side resources. (Ibid., mimeo., pp. 38-39.) With regard to utility sponsors, we still hope that one or more utilities will volunteer to conduct the pilot. Should that not occur, we direct the assigned ALJ, in consultation with the assigned Commissioner, to select the sponsors of the integrated bidding pilots at the appropriate time.

Finally, with regard to shareholder incentives, we note that we are currently considering a wide range of ratemaking approaches in response to a report on industry structure prepared by

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UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

TRANSPHASE SYSTEMS, INC., *Plaintiff.* v. SOUTHERN CALIFORNIA EDISON COMPANY and SAN DIEGO GAS AND ELECTRIC COMPANY, *Defendants.*	Docket No. CV-93-2552 KN (EX) COMPLAINT FOR ANTITRUST VIOLATIONS AND DEMAND FOR JURY TRIAL

Plaintiff, Transphase Systems, Inc., for its complaint against the defendants in this action for violation of the antitrust laws of the United States, respectfully alleges as follows:

I.

JURISDICTION AND VENUE

1. This action is brought, *inter alia,* pursuant to the antitrust laws of the United States, Title 15 U.S.C. §§ 1 and 2. This Court has original subject matter jurisdiction over this civil action, which arises under the laws of the United States, pursuant to 28 U.S.C. § 1331.

2. The two defendants (collectively the "utilities") transact business in the State of California and maintain a place of business within this State as well as within this judicial District. This Court has personal jurisdiction over each of the two defendants.

3. Each of the two defendants is a corporation and is subject to personal jurisdiction in this District at the time this action is commenced. As a consequence, venue is properly laid in this District against each of said defendants under 28 U.S.C. § 1391(c).

II.

THE PARTIES

4. Plaintiff, Transphase Systems, Inc., ("Transphase") is a corporation organized and existing under the laws of the Commonwealth of Virginia, and has a principal place of business in Huntington Beach, California, within the jurisdiction of this Court. Transphase is in the business of load management and conservation of energy, transferring the use of electrical energy from peak to off-peak periods as well as conserving energy and thereby enabling utilities such as defendants to reduce or defer the building of new electric generating power plants and to generate energy more efficiently at a more uniform rate. As will be explained in greater detail hereinafter, Transphase provides such electric capacity and manufacturing energy benefits by installing and operating thermal energy storage ("TES") systems, storing cooling capacity during off-peak hours and releasing this stored cooling capacity during peak hours. The generic field in which Transphase participates is called demand-side management ("DSM"), in which electric capacity and energy resources are provided through the operation of energy efficiency measures which reduce such capacity and energy requirements at facilities within the utilities' service territories. DSM resources may be contrasted with tradi-

tional generation of electric capacity and energy at power plants, either owned by the utilities or by independent power producers.

5. On information and belief, defendant Southern California Edison Company ("Edison") is the second largest electric utility in the United States, and is a California Corporation having a principal place of business in Rosemead, California, and offices in Los Angeles, California. As a regulated monopoly, it distributes and sells electricity to customers within a large segment of Los Angeles County and adjacent counties, all within the jurisdiction of this Court.

6. On information and belief, San Diego Gas and Electric Company ("SDG&E") is a corporation organized under the laws of the State of Delaware. It has a principal place of business in San Diego, California and, as a regulated monopoly, distributes and sells electricity within a large area of Southern California, including the County of Orange, within the jurisdiction of this Court.

III.

BACKGROUND FACTS

7. This complaint is against each of the several defendants for violation of the Sherman Act, §§ 1 and 2, and their California counterparts. In § 2, the Sherman Act states that every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons to monopolize any part of the trade or commerce among several states shall be guilty of a felony and subject to civil penalties. Each of said defendants is a regulated utility in the operation, distribution and sale of electrical energy within its specified territory.

A. The Economics of the Business of Plaintiff

8. Transphase is, as hereinbefore stated, in the business of load management and conservation of energy, generally referred to as DSM. As an example of its services, Transphase will contract with a third party, known as a host, to build and install a thermal energy storage ("TES") system at the facility of the host, whether it be a production facility, an office or a hospital. The system includes a tank, which is usually placed below grade and is located adjacent to an existing chiller that cools water used for air-conditioning the facility. Piping connects the tank to the chiller and to air handlers within the facility where the chilled water is used for air-conditioning purposes.

9. In the tank it has erected Transphase installs [sic] plastic containers filled with a proprietary eutectic salt mixture that freezes and melts at approximately 47°F. The bottles are self-nesting and self-stacking; they support each other and occupy the tank in a manner such that water can pass between and about the filled bottles, thereby either storing cooling capacity during a charging cycle, or releasing the stored cooling capacity from the frozen eutectic salts in the bottles during a discharge cycle.

10. In off-peak hours, such as the middle of the night when there is low use of electricity throughout the utilities service territories and rates are corresponding low for those on time-of-use rates, the building's chillers, which consume large quantities of electricity during their use, are activated to chill water to a temperature below 47°F and circulate that water through the tank containing the eutectic salt filled containers. Such chiller operation continues until the salts within the containers have been frozen. Then, during peak periods, e.g., the middle of a hot summer day, rather than utilizing the high energy-consuming chiller, a pump circulates water through the tank and about the frozen eutectic salt-filled containers, whereby the water is chilled to approx-

imately 47°F. That chilled water is pumped through the facility and used to air-condition it, then recirculated back to the tank where it is again cooled by the frozen salts and once more passed throughout the facility to air-condition it. Transphase also provides other energy and capacity saving DSM measures, including energy management control systems, heat exchangers, and the like.

11. In this way a Transphase system manages the electric load of a building and stores cooling capacity during off-peak periods, which capacity is used during peak periods. The result is that the peak electric load of the utilities can be reduced, which in turn eliminates or mitigates the need to build new power plants, as well as additional transmission and distribution equipment. In addition, there is less need for use of expensive-to-operate peaking power plants and a more efficient use of the utilities' energy producing power plants.

12. DSM resources, that is, electric energy and capacity savings provided by energy efficiency equipment, are cost effective and environmentally beneficial alternatives to building new power plants and generating electricity. Thus, the defendant utilities collectively receive from the ratepayers in their respective service territories, on information and belief, approximately $175 million per year for the provision of DSM under the assumption that it costs the ratepayers less to pay for DSM electricity savings on a kilowatt or kilowatt-hour basis than it does to pay for building new power plants, generating electricity, and transmitting and distributing it to the customer facilities.

The utilities include these DSM funds into the calculation of their rates for electricity and collect these funds from all the ratepayers through the customers' payment of their electric bills. The funds are generally used by the utilities to promote the provision of DSM resources and measures *e.g.*,

thermal energy storage, by payments to its host customers or developers who install the DSM measures.

13. Because of the goods and services provided by Transphase, those ratepayers in the State of California within the service areas of defendant utilities have and/or would enjoy monetary savings on their monthly energy bills. The DSM resources that Transphase provides benefit such ratepayers by offsetting the need for utilities to build power plants or buy electric capacity from independent power producers at a higher unit cost than the cost the ratepayers pay to Transphase for reducing the demand for electricity by conservation and load management. A benefit is provided to the individual host because its time-of-use electricity bill from a utility is dramatically reduced with the Transphase system in use.

14. The host customer that installs a Transphase system will reduce its electric bill by taking advantage of lower nighttime off-peak electric rates. However, it is usually considered uneconomic for a host to pay for the entirety of a Transphase system; the payback period, *i.e.*, the number of years until the host recoups the cost of the system, may be too long. As a consequence, utilities offer rebate programs to the host. Typically, if the cost to the utility of supplying electricity during peak periods is $2,000 per kilowatt, the utility may offer the host $250 for each kilowatt of electricity demand the host eliminates from its peak period. Each defendant utility designates the peak periods, which might extend from noon to 6 p.m., from June to September. Because of the utility's rebate program, the cost of a Transphase system to the host is reduced, such that there is a more rapid payback period. Thus, cooperation of the host, plaintiff and defendants could result in a sufficiently short pay-back to the host that it would install a Transphase system. Indeed, Transphase has installed about 60 systems in California, Arizona, and New Jersey.

15. The utility does not, in any rebate program it chooses to conduct, expend its own shareholders money for rebates, nor do such rebates inure to the direct detriment of the utility. On the contrary, all such rebates are paid by the ratepayers, together with all administrative costs of the utility, and often with a built-in profit to the utility.

16. One factor in determining the amount that the ratepayer, through the utility, will pay as a rebate for Transphase's DSM goods and services is the so-called avoided cost, which is the cost to the utility of producing or buying an additional unit of electricity during peak periods. By manipulation of their avoided costs, which are the maximum that a utility will pay a host for a Transphase system, the defendants can and have made it extremely difficult for Transphase to sell its services to the host. Such manipulation is but one example of the way in which the defendants control the DSM market and the price Transphase receives for its TES resources.

B. The Relevant Markets

17. The relevant geographic market for each utility/defendant is that service area in which the utility has a monopoly over the distribution and sale of electricity. The goods and services over which the utility exercises its monopoly in its market are, broadly speaking, DSM resources, and with specific respect to Transphase, retrofit thermal energy storage (TES) goods and services supplied by Transphase to hosts for the benefit of those hosts and electric capacity and energy savings provided to the ratepayers in the aggregate of the utility in those geographic markets.

C. The Effect on Commerce

18. The utilities exercise of their monopoly power has had a not insignificant effect on interstate commerce, se-

verely limiting such commerce in which Transphase has purchased and sold goods. Exemplarily, Transphase has purchased blow molding machines that were manufactured and shipped from Wisconsin to California, and has and does purchase chemicals that are shipped from Texas to California. Such shipments in interstate commerce would have been far greater had the utilities not pursued their unlawful, monopolistic practices.

IV.

ACTUAL MONOPOLIZATION

This Count is for actual monopolization by the utilities in violation of Title 15 United States Code § 2.

A. The Nature of the Monopoly Power

19. There is no way that Transphase can receive payment from California ratepayers in exchange for DSM resources that it provides except through the utilities. The utilities stand as an impediment to Transphase's selling its goods and services to the ratepayers of California because the ratepayers cannot negotiate directly with Transphase, which must deal with the ratepayers through the utilities. However, in so dealing, the TES services and goods that Transphase supplies are for the benefit of the ratepayers. The utilities/defendants have a monopoly over the furnishing of such goods and services of Transphase to the ratepayers, but the utilities are not themselves capable of supplying those goods and services to the ratepayers, only of preventing Transphase from so doing.

20. The utilities enjoy monopoly power by virtue of their ability to determine the prices of thermal energy storage systems and the electricity savings provided thereby to both the host customer and the DSM ratepayers. The utilities arbitrarily establish the avoided costs in an inconsistent and

manipulative manner. The utilities similarly establish the rebate levels for TES systems in no relationship to the cost of new power plants that such systems are designed to avoid. The utilities also establish the amount of DSM funds to be budgeted for thermal energy storage systems, and how much of these funds are to be spent on hardware and how much their own internal administrative expenses and paper studies which produce nothing, and the manner, or lack thereof of measuring and verifying that the electricity savings projected for the DSM measures are actually achieved. Thus, the utilities monopoly power includes the ability to determine the maximum price of the thermal energy storage system through its determination of the avoided costs, the payback periods to the host through the determination of the rebate levels, the size of the market through its economic manipulations and through its budgetary discretion and its verification of the product delivery (electricity savings) through its measurement and verification discretion.

B. Willful Acquisition of Monopoly Power

21. Defendants have unlawfully and wrongfully acquired their monopoly power. They acquired their monopolies over TES retrofit and DSM resources despite the express mandate of the California Business and Professional Code § 7042.1 (c) and Chapter 984 of the Statute of 1983, which expressly require that the energy conservation industry be allowed to develop in a competitive manner. Despite their knowledge of the law of the State of California, which is more fully set forth in ¶29 *infra,* defendants deliberately violated and took for themselves their monopoly power enumerated above in express contradiction of the statutory law.

C. Willful Maintenance of Monopoly Power

22. Once the utilities acquired their monopoly power, they have enthusiastically maintained it through the years.

Inter alia, they have actively resisted any meaningful changes to the rebate programs that should have been construed to allow Transphase and other DSM providers to compete on a level playing field with either the utility itself or independent power providers. Thus, they have actively resisted pricing their rebates based on the avoided cost of the utility — in not having build [sic] new power plants, for example. They have actively resisted competitive bidding between DSM and supply-side options by simply refusing to allow Transphase to bid its DSM resources in such solicitations, or bidding or standard offer pricing by varying their avoided costs in an amazing and fraudulent manner to prevent Transphase from bidding on utility solicitations for new power capacity and energy. They have resisted accurate measurement criteria that would apply to themselves and others, where the ratepayers would pay themselves or others such as Transphase on the basis of measured savings of electricity, and in the process they have squandered ratepayer funds by paying for electricity savings which are never provided. They have similarly squandered ratepayer DSM funds on their own grossly disproportionate internal administrative expenses or paper studies that do not save one kilowatt or kilowatt hour of electricity.

23. Once the utility receives DSM funds from its ratepayers, it totally controls and changes budgets, sets rebate levels, decides how much will be spent on its own internal administration, on paper studies that lead nowhere, and how much, if anything, will actually be spent to save money for the ratepayers of California. Each utility has a service organization with extensive host contacts that actively intervene with customers seeking to install TES goods and services, particularly where rebates are involved.

24. As competitors of Transphase in their relevant geographic markets, the utilities have and are unfairly competing with Transphase, for example, by using different avoided

costs for themselves and for Transphase. By unilaterally determining their avoided costs as one amount for themselves and another for the plaintiff, the utilities have unfairly prevented Transphase from competing with them on either their supply-side or demand-side projects. Since each utility has the power to determine its own avoided cost for DSM resources, the utility can and has used its monopoly in the sale of electricity to ratepayers to further its illegal monopoly in the sale of DSM services to ratepayers, a classic case of monopoly leveraging.

25. This exercise of monopoly power did not come to the defendants/utilities from growth or development as a consequence of a superior product, business acumen or historic accident. The utilities simply took their DSM monopolies and willfully maintained them although they basically do nothing to supply such DSM resources to the ratepayers of California but hire others and charge large administrative costs and profits. As stated, the utilities are not capable of supplying Transphase or other eutectic salt storage systems to the ratepayers; they are, however, by the willful maintenance of their monopoly power, *i.e.,* by appointing themselves to determine rebates to hosts, and varying their own avoided costs, perfectly capable of and have prevented Transphase from rendering its DSM resources to ratepayers in the aggregate and its TES systems to specific host customers.

D. Causal Injury to Transphase

26. Transphase Systems, Inc. has been in business in the State of California for more than ten years, rendering TES retrofit goods and services. During that period of time Transphase has struggled to remain in business despite the low rebate level dictated by the defendant utilities. As previously pointed out, the host is motivated to purchase Transphase systems by the payback period during which the

host will recoup its expenditures for the Transphase TES system. Transphase is, on information and belief, the leading supplier of retrofit TES systems in the State of California. Had Transphase or its host customers received payments for its electric savings at the same average price that the utilities pay independent power producers, which, on information and belief, is $1,500 per kilowatt, Transphase's market size and profits would have multiplied dramatically. Had Transphase been permitted to bid against supply-side bidders, and the utilities, themselves, Transphase would have been the successful bidder on a large proportion of such solicitations. On information and belief, one of the utilities has paid at least $2,200 per kilowatt for electrical energy supplied by a geothermal source. This should be contrasted with the $200 per kilowatt that an electric utility might magnanimously provide to Transphase or host customers for its TES goods and services, all in the name of the ratepayers. Had Transphase been permitted to bid against the geothermal electricity supplier, it is obvious that Transphase could have bid $1,000 per kilowatt rather than the $200 per kilowatt award that the utility offers it as a rebate.

27. Defendants' artificially low rebate levels, their constantly changing programs and manipulation of avoided costs, have seriously constrained Transphase's market and reduced the price Transphase is able to offer the host in an attempt to obtain an acceptable payback. Indeed, had Transphase been permitted to bid in an open and free market to the ratepayers of the State of California without the intervention and manipulation of the defendant utilities, Transphase could have made a profit while supplying its systems to the host at a very low payback and in some cases free-of-charge, which would have immensely multiplied its market. In such instance the host would have received significant electric bill savings, the ratepayers of California would have saved money and been spared further polluting power plants burning fossil fuels, and the utilities would

minimally be where they should be: operating their existing power plants and distributing electricity. While damages have not yet been completely ascertained, the value of plaintiff had the utilities not acquired and maintained their monopoly power would have been at least $50,000,000 more than the value of the company at present.

V.

ATTEMPTED MONOPOLIZATION AND CONSPIRACY TO MONOPOLIZE

28. This Count is for attempted monopolization and conspiracy to monopolize under 15 U.S.C. § 2. Plaintiff repeats the averments contained in ¶¶ 1 to 27 of this Complaint insofar as they are applicable to this Count.

29. Defendant utilities have and are attempting to monopolize their respective geographic DSM relevant markets and have been successful in such attempts. They gained control of DSM markets willfully and with specific intent to monopolize. They deliberately sought and obtained such control. Their conduct has been anticompetitive; they have not permitted Transphase access to the ratepayers funds they control, except through them. There is a dangerous probability of their success in achieving monopoly power in their relevant markets.

30. On information and belief, defendant utilities have conspired with each other to monopolize the sale of DSM goods and services in their respective geographic DSM markets. They speak in unison before public regulatory bodies to demand the fruits of their monopolies. When opposing a Transphase appeal, they have even filed briefs jointly. Each has and is helping the others so that each can consolidate and further the achievement of its monopoly power in its geographic area of monopoly.

31. As with actual monopolization, the attempted monopolization and conspiracy to monopolize acts by defendants have greatly injured Transphase, which has a unique patented system and, on information and belief, has been the only supplier of eutectic salt-based TES systems in California for the past ten years. Had defendants not attempted to monopolize and conspired to monopolize the relevant markets in their geographic areas, plaintiff would have successfully underbid both defendants and supply-side bidders for reducing demand for electricity during peak usage periods. Because of defendants' acts, Transphase has suffered a severe diminution in the value of its net worth during the past four years, such diminution being at least $50 million.

VI.

THE STATE ACTION DOCTRINE DOES NOT IMMUNIZE DEFENDANTS' MONOPOLIZATION

32. For reasons best known to the State of California, this State has granted such monopolies to the respective defendants and has thereby secured to such defendants immunity from the Federal Antitrust Laws, including 15 U.S.C. § 2, under the doctrine of *Parker v. Brown*, 317 U.S. 341 (1943), although that doctrine has been judicially questioned. However, such immunity, which is sometimes described as "state action immunity," is derived from legislative enactment, and is limited to the monopoly specifically granted thereby. Transphase is not here decrying the monopoly of the defendants' utilities in the distribution and sale of energy, nor is it asking this Court to hold that such regulated monopolies are not immune from the reach of the Sherman Act under the state action doctrine in exercising that monopoly. It is alleging that the utilities' state action immunity does not extent to demand-side management.

33. The monopoly enjoyed by the defendant utilities here is not one which is subject to the state action doctrine, which renders a utility immune from Federal Antitrust laws. In Business and Professional Code § 7042.1 (c) the State of California has declared that " . . . [i]t is the intention of the legislature in enacting this section that public utility regulations be clearly based on the principle that the energy conservation industry should be allowed to develop in a competitive manner, as declared in Chapter 984 of the Statute of 1983." Chapter 984 recites in pertinent part:

> Section 1. The legislature finds and declares it is in the best interest of the state to *ensure competition in the energy conservation industry because of innovation, price competition, aggressive marketing, and freedom of entry which characterize competitive industries*, and that the energy conservation industry, because of its decentralized nature, has the potential to be truly competitive.
>
> The Legislature further finds and declares that the current uncertainty with regard to the role of electrical and gas corporations subject to regulations as public utilities by the Public Utilities Commission with regard to energy conservation development hinders the full-scale development of the energy conservation industry, and therefore requires legislative clarification.
>
> * * *
>
> The legislature further finds and declares that there may be an inherent conflict for a public utility which furnishes gas and electricity on the one hand and installs energy conservation materials or devices on the other hand, and that *it would be detrimental to the energy industry and to the state if privately-owned public utilities used their status as monopolies to domi-*

nate the energy conservation industry or exercise unfair market power.

* * *

The Legislature further finds and declares that the basis for regulation of public utilities extends to their participation in energy conservation development as well as in the production and delivery of forms of energy derived from conventional sources.

* * *

It is, therefore, the intent of the Legislature that the Public Utilities Commission be given a clear and *explicit mandate to regulate* the involvement of electrical and gas corporations in energy conservation development, and *to ensure that the energy conservation industry develops in a manner which is competitive and free from the potential dominance of regulated electrical and gas corporations.* [emphases added].

34. Thus, Bus. & Prof. Code § 7042.1 mandates that the CPUC regulate the delivery of DSM programs in a manner that is competitive and free from the potential dominance of regulated electrical and gas corporations. Thus, for purposes both of state and federal antitrust laws, the State of California has a clearly articulated policy in favor of promoting competition in the energy conservation industry and preventing the dominance, let alone monopolization of the regulated utilities.

35. In addition, the utilities fail the other criterion required for state action immunity — close regulatory scrutiny. The regulators provide the utilities immense freedom to establish rebate levels, establish DSM budgets, DSM measurement criteria, etc.

36. It is clear, therefore, that the state action doctrine, however it may protect these privately owned utilities from the reach of the antitrust laws for the distribution and sale of electricity, does not reach to the conservation and reduction in the demand for electricity, *i.e.,* demand-side management, whether it takes the form of conservation or load management or any other form of reducing the demand as opposed to increasing the supply of electricity.

VII.

VIOLATION OF THE CALIFORNIA UNFAIR PRACTICES ACT

37. This Count is for damages and injunctive relief based on defendants' violation of the Unfair Practices Act, Cal. Bus. & Prof. Code §§ 17000 to 17101. Plaintiff repeats the averments contained in ¶¶ 1 to 36 of this Complaint insofar as they are applicable to this Count.

38. This Court has subject matter and personal jurisdiction over defendants on this court for the reasons set forth and regard to Federal jurisdiction, and under the doctrine of pendent jurisdiction. Venue is properly laid in this district.

39. The acts of defendants that constitute actual monoplization [sic], attempted monopolization, and conspiracy to monopolize under 15 U.S.C. § 2 also constitute a violation of the California Unfair Practices Act, whose purpose is ". . . to safeguard the public against the creation or perpetuation of the monopolies and to force and encourage competition . . . ." Plaintiff has been severely damaged by defendants' unfair practices and seeks relief from this Court.

VIII.

VIOLATION OF TITLE 15 U.S.C. §1

40. This Count is for damages and injunctive relief for a combination and conspiracy among the defendants and restraint of trade in violation of § 1 of the Sherman Act. Plaintiff repeats the averments contained in ¶¶ 1 to 39 of this Complaint insofar as they are applicable to this Count.

41. This Court has subject matter and personal jurisdiction over defendants on this count, and venue is properly laid in this district, all for the reasons set forth in ¶¶ 5 to 7 of this complaint.

42. On information and belief, defendants have combined and conspired to restrain commerce among the various states by deliberately adjusting their avoided costs, appearing together before regulatory and other bodies to take positions that will disadvantage Transphase Systems, Inc. and will make it impossible for Transphase to bid on projects that provide DSM services to the ratepayers of the State of California. In combination and conspiracy, defendant utilities have opposed and manipulated their regulation such that there is no bidding between suppliers of supply-side management (SSM) and those who supply DSM services, such as Transphase Systems, Inc. Thus, the utilities pay suppliers of electrical energy amounts that are greater than those they impose as the limit of what they will pay DSM suppliers, including Transphase. The utilities have also conspired to restrain trade by establishing artificially low rebate levels for TES and by establishing measurement standards for themselves which are complete different from standards that would be applied to independent DSM suppliers. By means of such manipulations, which are performed in combination, the utilities have created a two-tier market: one for supply-side and another for demand-side goods and services. By favoring the supply-side services,

they have furthered their monopolies in the distribution and sale of electricity, as SSM companies must distribute the electricity they generate over lines controlled by the utilities. The utilities disfavor DSM services provided by independent companies such as Transphase. Since those services are provided directly to the hosts, for the benefit of the hosts and the ratepayers, and other than monitoring the savings of electricity, the utilities have no monopolistic control over such DSM services.

43. By combining and conspiring to restrain trade in its DSM goods and services, defendants have severely harmed plaintiff herein and forced its business to be greatly diminished within the State of California and, because of its purchases and delivery of goods from outside the State of California, have restrained interstate commerce. Defendants will continue to restrain such commerce unless and until they are enjoined by this Court.

IX.

VIOLATION OF THE CARTWRIGHT ACT

44. This Count is for damages and injunctive relief based on defendants' violation Cartwright Act, Cal. Bus. & Prof. Code §§ 16700 to 16770. Plaintiff repeats the averments contained in ¶¶ 1 to 43 of this Complaint insofar as they are applicable to this Count.

45. This Court has subject matter and personal jurisdiction over defendants on this count for the reasons set forth in regard to Federal jurisdiction and under the doctrine of pendent jurisdiction. Venue is properly laid in this district.

46. The acts of defendants that constitute a violation of 15 U.S.C. § 1 — a combination and conspiracy in restraint of trade — also constitute a trust of which defendants are

members. They have acted in pursuant [sic] of the trust for the following purposes:

(a) To create and carry out restrictions and trade and commerce in this State;

(b) To limit and reduce the production of DSM and TES goods and commodities by plaintiff in this State;

(c) To prevent competition by Transphase in the sale of DSM goods and services in this State, and

(d) To fix prices at which Transphase's goods and services may be offered to the public in this State all in violation of Cal. Bus. & Prof. Code §§ 16720(a) to (d).

WHEREFORE, plaintiff Transphase Systems, Inc. respectfully prays this Court for an order:

A. Granting judgment in favor of plaintiff and against each of the defendants herein;

B. Enjoining each of the defendants from accepting or awarding bids or offers from any independent power producer in any solicitation using ratepayer funds unless and until Transphase and other DSM providers are allowed to compete in the solicitation and in which awards are made to responsive, responsible bidders based on the lowest cost for electric capacity and energy either from generation or DSM electricity savings.

C. Enjoining each of the defendants from taking for themselves or distributing to others, except in fulfilling contractual obligations entered into prior to the filing of this Complaint, any ratepayer funds for DSM resources unless and until Transphase and other DSM providers are allowed to compete with the defendant utility to provide the DSM resources to the ratepayers from thermal energy storage retrofits and other DSM measures on the basis of the lowest

cost, measurable electric capacity and energy savings in avoidance of the costs to generate power and energy to the ratepayers.

D. Enjoining each of the defendants from taking for themselves or distributing to others, except in fulfilling contractual obligations entered into prior to the filing of this Complaint, any ratepayer funds for DSM resources unless and until Transphase and other DSM providers are paid on a continuing basis the average price of electricity capacity and energy paid to independent power producers by the defendants.

E. Awarding to plaintiff the amount of actual damages that it has suffered by each of the defendants' unlawful practices as pleaded hereinbefore, and that such amount be trebled in accordance with 15 U.S.C. §15 and applicable provisions of the Cal. Bus. & Prof. Code;

F. Awarding to plaintiff its reasonable attorney's fees under 15 U.S.C. §15 and Cal. Bus. & Prof. Code.

G. Awarding to plaintiff prejudgment interest based on the damages that it has sustained because of defendants' unlawful conduct, as well as its costs incurred in this action, all under 15 U.S.C. §15 and the Cal. Bus. & Prof. Code.

H. Directing the attorney general or a district attorney to institute proceedings against each of the defendants for the forfeiture of its monopoly status in the distribution and sale of electricity within the State of California, as set forth in Cal. Bus. & Prof. Code, and

I. For such other and further relief as to this Court shall appear just and equitable.

TRANSPHASE SYSTEMS, INC.

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DEMAND FOR JURY TRIAL

Pursuant to Rule 38(b), F.R.Civ.P., plaintiff demands trial by jury on all issues in this action that can be tried to a jury.

Walter D. Ames
Attorney for Plaintiff

Supreme Court, U.S.
F I L E D
OCT 1 8 1994
OFFICE OF THE CLERK

No. 94-394

IN THE SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1994

TRANSPHASE SYSTEMS, INC.,

Petitioner,

v.

SOUTHERN CALIFORNIA EDISON COMPANY
AND SAN DIEGO GAS AND ELECTRIC COMPANY,

Respondents.

Petition for a Writ of Certiorari to the
United States Court of Appeals
for the Ninth Circuit

PETITIONER'S REPLY BRIEF

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October 14, 1994

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Transphase Systems, Inc. ("Transphase") hereby replies to Briefs In Opposition filed by Southern California Edison Company ("SCE") and San Diego Gas and Electric Company ("SDG&E").

I. This Court's Holdings in *Omni Outdoor Advertising* and *Cantor v. Detroit Edison Co.* Answer Question 1 And Are Properly Before this Court.

Question 1 (from SCE Opp. to Pet. at i):
Does the "state action" doctrine as enunciated in Parker v. Brown, 317 U.S. 341 (1943), and its progeny apply to private conduct alleged to be in violation of Section 2 of the Sherman Act? (emphasis added)

Answer:
"This does not mean, of course, that the States may exempt private action from the scope of the Sherman Act..." (emphasis in original)
City of Columbia v. Omni Outdoor Advertising, 499 U.S. 365, 379, 111 S.Ct. 1341, 1353 (1991), citing and quoting Parker v. Brown, supra. See Pet. at 18. In both Omni and Cantor v. Detroit Edison Co., 418 U.S. 97 (1980), this Court has emphasized that the "state-action" doctrine may not be applied to exempt private conduct, particularly in a monopolization case where no natural monopoly exists. Pet. at 21, 22.

Transphase fully argued at both the Ninth Circuit and District Court courts that the state-action exemption is not available to utilities charged with monopolization, in reliance on Omni and Cantor, supra. SDG&E proclaims that because the lower courts did not "address" these holdings, the issues cannot be considered by this Court in reliance on Moor v.

County of Alameda, 411 U.S. 693, 696 n.3 (1973) et. al. (SDG&E Opp. to Pet. at 6). However, SDG&E has transposed the word "decided" from Moor, et. al. with "addressed" - in the process deceptively suggesting a new standard for the Court. Of course the lower courts in the case at bar "decided" that the state-action doctrine is available to the defendant private utilities; in fact, it was the sole basis upon which the Ninth Circuit granted respondents an exemption from federal law. Indeed, since Transphase petitions this Court from the Ninth Circuit's decision, the state-action doctrine's availability and application to the respondent private utility corporations are the only issues properly before this Court.[1]

Both SCE and SDG&E solely rely on Patrick v. Burget, 486 U.S. 94 (1988), to attempt to discredit Transphase's distinguishment between Cantor, Town of Concord, and City of Mishawaka I and II, involving Section 2 monopolization claims against private parties where the Courts found state-action immunity totally inapposite; and Parker, Midcal, So. Motor Carriers, and FTC v. Ticor, involving conspiracy claims wherein the State's action might vitiate the private

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[1]Both SCE and SDG&E raise other arguments they forwarded in support of their Rule 12(b)(6) motions, again neglecting to mention that the District Court explicitly allowed Transphase leave to amend its Original Complaint should immunity be unavailable. Pet. at 6, App. 16a, n.10. The Ninth Circuit also rejected *sub-silentio* Noerr-Pennington immunity in the case at bar because Transphase's monopolization claims do not challenge SCE and SDG&E's right to petition the State or California Public Utilities Commission ("CPUC") for anything, but rather challenge their private acts which may indirectly result from the outcome of the CPUC proceedings. See Omni, supra, 111 S.Ct. at 1354.

conspiracy.[2] While the Patrick decision is unclear on the point, the jury returned a verdict on the §2 claims against all the defendants, 486 U.S. at 98. Since the violation was incurred by individual surgeons operating in the same geographic and product market, this suggests a conspiracy to monopolize rather than an actual monopolization.

As noted in Transphase's Petition at 20, n. 6, conspiracy to monopolize should be grouped with §1 conspiracies in restraint in trade for purposes of a "state-action" analysis because a private conspiracy can be obviated by the State's action. Also, the underlying question of whether the state-action doctrine applied to private conduct was not at issue in Patrick, supra. Further, Transphase's distinguishment would not disturb Patrick's decision that state-action immunity was unavailable to the defendants in that case.

Both SCE and SDG&E emotionally emphasize that Transphase's argument, if adopted, would lead to repeated monopolization attacks against utilities across the country. First, that is an argument that should be made to Congress, which enacted the Sherman Act, not the judiciary. Second,

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[2]See Town of Concord, Mass. v. Boston Electric Co., 915 F.2d 12 (1st Cir) cert. denied, 449 U.S. 931 (1991), City of Mishawaka, Indiana v. Indiana and Michigan Electric Co., 560 F.2d 1314 (7th Cir), cert. denied, 436 U.S. 922 (1978) (Mishawaka I); City of Mishawaka, Indiana v. American Electric Power Co., 616 F.2d 976 (7th Cir.), cert. denied 449 U.S. 1096 (1981) (Mishawaka II); California Retail Liquor Dealer's Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97 (1980); Southern Motor Carriers Rate Conf. v. U.S., 471 U.S. 48 (1985); FTC v. Ticor Title Ins. Co., 112 S.Ct. 2169 (1992).

where this Court has addressed this concern, in FTC v. Ticor, 112 S.Ct. at 2180 et. seq., and Cantor v. Detroit Edison, 428 U.S. at 598 et. seq., it has found the policies of the Sherman Act to override any concern over litigation against private parties. Finally, establishing monopolization in violation of Section 2 of the Sherman Act is a difficult proposition, with the plaintiff needing to prove at trial monopoly power in the relevant market, predatory conduct and causal antitrust injury. If the defendants are not violating a federal law, then they will not be found liable.

II. The Utilities' Argument will Eviscerate the First Prong of the Midcal Test for any State-Regulated Private Party.

If the state-action immunity doctrine is available, then the utilities must satisfy both prongs of the Midcal test. See FTC v. Ticor, supra, Pet. at 24. However, the utilities argue, and the lower courts here held, that the first prong of the Midcal test is inapplicable to any state-regulated corporation.

Every California statute and code section cited by Transphase and the utilities provides the California Public Utilities Commission with an authority to regulate. But if that is all that is required, as the utilities maintain, every state-regulated corporation across the country passes the test by definition. Indeed the utilities continue to uphold the District Court's reliance on PU Code §454 (a), a code dating back to 1915 that has nothing to do with the energy efficiency marketplace, as the basic authority meeting Midcal's first prong.

There may never be another case where the State, through its statutes and codes, more clearly articulates a

policy promoting competition and opposing the utilities' "status as monopolies to dominate the energy conservation industry or [their] exercise of unfair market power." Chapter 984, Stats. 1983, Pet. at 4. This Court should refocus the inquiry on the State's intent to promote or displace competition, and not allow lower courts to read Midcal's first prong out of existence. See Omni, supra, Pet. at 25.

III. The Lower Courts Should Not Be Allowed to Determine the "Fact-Bound" Issue of PUC Control Under Rule 12(b)(6) Without Even Considering Transphase's Submitted Evidence.

Nowhere in SCE's 81 pages of CPUC documents submitted to this Court does the CPUC specify the energy efficiency rebate prices of $0, $100, $200, and $600 per kilowatt foisted on the marketplace by SCE and SDG&E. Nowhere does the CPUC command the utilities to destroy the energy efficiency marketplace by now instituting a price of $0 per kilowatt.[3] These prices - and lack of CPUC approval or consideration of them - are all facts which Transphase could and did substantially prove in its submission to the District Court and which the Ninth Circuit and District Courts refused to consider.

SCE further misleads this Court by suggesting that the District Court in Yeager's Fuel converted the utility's Federal Rule 12(b)(6) Motion to Rule 56 motion for

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[3]In fact, the CPUC, under its cost-effectiveness test, provides the utilities broad authority to set the price at anywhere between $0 per kw and up to $6000 per kw (the higher-end price that SCE and SDG&E pays to independent power producers). See Pet. at 8,9, n. 2.

summary judgment on an issue not related to state-action immunity (SCE Opp. to Pet. at 28). To the contrary, as the Third Circuit noted, "Attached to [the utility's 12(b)(6)] motion were various documents offered in support of its state action immunity defense." 22 F.3d at 1272. From the Third Circuit's discussion, it is clear that the documents in question were PUC documents, and the attachment of those documents to the 12(b)(6) motion triggered the District Court's conversion to a motion for summary judgment.

There is a conflict here between the Third Circuit, the plain meaning of the words of Rule 12(b), and the notes to Evidence Rule 201(b), on the one hand, and the Ninth Circuit and District Courts in the case at bar. The Courts below made grossly improper "fact-bound" determinations on a 12(b)(6) motion without considering Transphase's submitted evidence.

IV. Conclusion

The utilities should not be allowed sweeping immunity from the most basic national policy of a competitive and free marketplace embodied in Section 2 of the Sherman Act. Transphase's Petition for Certiorari should be granted.

Respectfully submitted,

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